Asia/Pacific Group
on Money Laundering

# ASIA/PACIFIC GROUP
# ON MONEY LAUNDERING

# APG MUTUAL EVALUATION REPORT ON
# SRI LANKA

**Against the FATF 40 Recommendations (2003) and 9 Special Recommendations**

## As Adopted by APG members

## 5 July 2006

# TABLE OF CONTENTS

Page

Preface - information and methodology used for the evaluation ....4

**Executive Summary ....5**

**1 General ....16**
1.1 General information on SRI LANKA ....16
1.2 General Situation of Money Laundering and Financing of Terrorism ....17
1.3 Overview of the Financial Sector and DNFBP ....20
1.4 Overview of commercial laws and mechanisms governing legal persons and arrangements ....22
1.5 Overview of strategy to prevent money laundering and terrorist financing ....23
**2 Legal System and Related Institutional Measures ....28**
2.1 Criminalisation of Money Laundering (R.1 & 2) ....28
2.1.1 Description and Analysis ....28
2.1.2 Recommendations and Comments ....31
2.1.2 Compliance with Recommendations 1 & 2 ....32
2.2 Criminalisation of Terrorist Financing (SR.II) ....32
2.2.1 Description and Analysis ....32
2.2.2 Recommendations and Comments ....36
2.2.3 Compliance with Special Recommendation II ....37
2.3 Confiscation, freezing and seizing of proceeds of crime (R.3) ....37
2.3.1 Description and Analysis ....37
2.3.2 Recommendations and Comments ....40
2.3.3 Compliance with Recommendation 3 ....40
2.4 Freezing of funds used for terrorist financing (SR.III) ....41
2.4.1 Description and Analysis ....41
2.4.2 Recommendations and Comments ....44
2.4.3 Compliance with Special Recommendation III ....44
**2.5 THE FINANCIAL INTELLIGENCE UNIT AND ITS FUNCTIONS (R.26, 30 & 32)** ....44
2.5.1 DESCRIPTION AND ANALYSIS ....45
2.5.2 RECOMMENDATIONS AND COMMENTS ....49
2.5.3 COMPLIANCE WITH RECOMMENDATIONS 26, 30 & 32 ....49
**2.6 LAW ENFORCEMENT, PROSECUTION AND OTHER COMPETENT AUTHORITIES – THE FRAMEWORK FOR THE INVESTIGATION AND PROSECUTION OF OFFENCES, AND FOR CONFISCATION AND FREEZING (R.27, 28, 30 & 32)** ....50
2.6.1 DESCRIPTION AND ANALYSIS ....50
2.6.2 RECOMMENDATIONS AND COMMENTS ....53
2.6.3 COMPLIANCE WITH RECOMMENDATION 27, 28, 30 & 32 ....54
**2.7 CROSS BORDER DECLARATION OR DISCLOSURE (SR.IX)** ....54
2.7.1 DESCRIPTION AND ANALYSIS ....54
2.7.2 Recommendations and Comments ....56
2.7.3 Compliance with SPECIAL Recommendations IX ....56
**3 Preventive Measures – Financial Institutions ....57**
3.1 Risk of money laundering or terrorist financing ....58
3.2 Customer due diligence, including enhanced or reduced measures (R.5 to 8) ....58
3.2.1 DESCRIPTION AND ANALYSIS ....58
3.2.2 RECOMMENDATIONS AND COMMENTS ....61
3.2.3 COMPLIANCE WITH RECOMMENDATIONS 5 TO 8 ....62
**3.3 THIRD PARTIES AND INTRODUCED BUSINESS (R.9)** ....63
3.3.1 DESCRIPTION AND ANALYSIS ....63
3.3.2 RECOMMENDATIONS AND COMMENTS ....63

3.3.3 COMPLIANCE WITH RECOMMENDATION 9 .... 63
3.4 Financial institution secrecy or confidentiality (R.4) .... 64
3.4.1 Description and Analysis .... 64
*Banking Sector* .... 64
3.4.2 Recommendations and Comments .... 66
3.4.3 Compliance with Recommendation 4 .... 66
3.5 Record keeping and wire transfer rules (R.10 & SR.VII) .... 66
3.5.1 Description and Analysis .... 66
*Recommendation 10* .... 66
3.5.2 Recommendations and Comments .... 69
3.5.3 Compliance with Recommendation 10 and Special Recommendation VII .... 70
3.6 Monitoring of transactions and relationships (R.11 & 21) .... 70
3.6.1 Description and Analysis .... 70
3.6.2 Recommendations and Comments .... 72
3.6.3 Compliance with Recommendations 11 & 21 .... 73
3.7 Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV) .... 73
3.7.2 Recommendations and Comments .... 76
3.7.3 Compliance with Recommendations 13, 14, 19 and 25 (criteriON 25.2), and Special Recommendation IV .... 76
3.8 Internal controls, compliance, audit and foreign branches (R.15 & 22) .... 77
3.8.1 Description and Analysis .... 77
*Recommendation 15* .... 77
3.8.2 Recommendations and Comments .... 78
3.8.3 Compliance with Recommendations 15 & 22 .... 78
3.9 Shell banks (R.18) .... 79
3.9.1 Description and Analysis .... 79
3.9.2 Recommendations and Comments .... 79
3.9.3 Compliance with Recommendation 18 .... 79
3.10 The supervisory and oversight system - competent authorities and SROs .... 80
Role, functions, duties and powers (including sanctions) (R.23, 30, 29, 17, 32 & 25) .... 80
3.10.1 Description and Analysis .... 80
3.10.2 Recommendations and Comments .... 88
3.10.3 Compliance with Recommendations 23, 30, 29, 17, 32, and 25 .... 88
3.11 Money or value transfer services (SR.VI) .... 90
3.11.1 Description and Analysis (summary) .... 90
3.11.2 RECOMMENDATIONS AND COMMENTS .... 90
3.11.3 COMPLIANCE WITH SPECIAL RECOMMENDATION VI .... 91
**4 Preventive Measures – Designated Non-Financial Businesses and Professions .... 92**
4.1 Customer due diligence and record-keeping (R.12) .... 92
(applying R.5, 6, 8 to 11, & 17) .... 92
4.1.1 Description and Analysis .... 92
4.1.2 Recommendations and Comments .... 93
4.1.3 Compliance with Recommendation 12 .... 94
4.2 Suspicious transaction reporting (R.16) .... 94
(applying R.13-15, 17 & 21) .... 94
4.2.1 Description and Analysis .... 94
4.2.2 Recommendations and Comments .... 95
4.2.3 Compliance with Recommendation 16 .... 95
4.3 Regulation, supervision and monitoring (R. 24-25) .... 95
4.3.1 Description and Analysis .... 95
4.3.2 Recommendations and Comments .... 98
4.3.3 Compliance with RecommendationS 24 & 25 (criterion 25.1, DNFBP) .... 99
4.4 OTHER NON-FINANCIAL BUSINESSES AND PROFESSIONS – MODERN secure TRANSACTION TECHNIQUES (R.20) .... 99
4.4.1 Description and Analysis .... 99
4.4.2 Recommendations and Comments .... 100

4.4.3 Compliance with Recommendation 20 ....... 100
**5 Legal Persons and Arrangements & Non-Profit Organisations ....... 101**
5.1 Legal Persons – Access to beneficial ownership and control information (R.33) ....... 101
5.1.1 Description and Analysis ....... 101
5.1.2 Recommendations and Comments ....... 102
5.1.3 Compliance with Recommendation 33 ....... 103
5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34) 103
5.2.1 Description and Analysis ....... 103
5.2.2 Recommendations and Comments ....... 103
5.2.3 Compliance with Recommendations 34 ....... 104
5.3 Non-profit organisations (SR.VIII) ....... 104
5.3.1 Description and Analysis ....... 104
5.3.2 Recommendations and Comments ....... 106
5.3.3 Compliance with Special Recommendation VIII ....... 107
**6 National and International Co-operation ....... 108**
6.1 National co-operation and coordination (R.31 & 32) ....... 108
6.1.1 Description and Analysis ....... 108
6.1.2 Recommendations and Comments ....... 109
6.1.3 Compliance with Recommendation 31 ....... 109
6.2 The Conventions and UN Special Resolutions (R.35 & SR.I) ....... 110
6.2.1 Description and Analysis ....... 110
6.2.2 Recommendations and Comments ....... 110
6.2.3 Compliance with Recommendation 35 and Special Recommendation I ....... 110
6.3 Mutual Legal Assistance (R.32, 36-38, SR.V) ....... 110
6.3.1 Description and Analysis ....... 110
6.3.2 Recommendations and Comments ....... 113
6.3.3 Compliance with Recommendations 32, 36 to 38, and Special Recommendation V 113
6.4 Extradition (R.32, 37 & 39, & SR.V) ....... 114
6.4.1 Description and Analysis ....... 114
6.4.2 Recommendations and Comments ....... 116
6.4.3 Compliance with Recommendations 32, 37 & 39, and Special Recommendation V 116
6.5 Other Forms of International Co-operation (R.32 & 40, & SR.V) ....... 116
6.5.1 Description and Analysis ....... 116
6.5.2 Recommendations and Comments ....... 117
6.5.3 Compliance with Recommendations 32 & 40, and Special Recommendation V ....... 117
**7 OTHER ISSUES ....... 118**
7.1 Other relevant AML/CFT measures or issues ....... 118
**8 TABLES ....... 119**
Table 1. Ratings of Compliance with FATF Recommendations ....... 119
Table 2: Recommended Action Plan to Improve the AML/CFT System ....... 126
Table 3 Authorities' Response to the Evaluation ....... 135
**9 ANNEXES ....... 139**
Annex 1: List of abbreviations ....... 139
Annex 2: Details of all bodies met on the on-site mission - Ministries, other government authorities or bodies, private sector representatives and others ....... 140
Annex 3: List of all laws, regulations and other measures ....... 141

## PREFACE - INFORMATION AND METHODOLOGY USED FOR THE EVALUATION

1. The evaluation of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of Sri Lanka was based on the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF), and was prepared using the AML/CFT Methodology 2004. The evaluation was based on the laws, regulations and other materials as they existed at the time of the mutual evaluation as supplied by Sri Lanka, and information obtained by the Evaluation Team during its on-site visit to Sri Lanka from 27 February to 11 March 2006, and subsequently. During the on-site visit the Evaluation Team met with officials and representatives of all relevant Sri Lanka government agencies and the private sector. A list of the bodies met is set out in Annex 2 to the mutual evaluation report.

2. The evaluation was conducted by a team of assessors composed of APG experts in criminal law, law enforcement and regulatory issues. The Evaluation Team consisted of:

- Legal Expert – Dr Gordon Hook, Manager, Criminal and International Law, Ministry of Justice, New Zealand;
- Financial/Regulatory Experts – Mr Vincent Jalbert, Senior Project Leader, Financial Sector Division, Finance Canada and Mr Prashant Saran, Chief General Manager, Reserve Bank of India;
- Law Enforcement Expert – Senior Police Inspector, Mr Francis Ming-kei LI, Senior Inspector, Hong Kong Police;
- APG Secretariat representative – Mr Eliot Kennedy, Principal Executive Officer.

3. The experts reviewed the institutional framework, the relevant AML/CFT laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions and Designated Non-Financial Businesses and Professions (DNFBP), as well as examining the capacity, the implementation and the effectiveness of all these systems.

4. This report provides a summary of the AML/CFT measures in place in Sri Lanka as at the date of the on-site visit or immediately thereafter. It describes and analyses those measures, and provides recommendations on how certain aspects of the system could be strengthened (see Table 2). It also sets out Sri Lanka's levels of compliance with the FATF 40+9 Recommendations (see Table 1).

# EXECUTIVE SUMMARY

## Background Information

1. This report provides a summary of the AML/CFT measures in place in Sri Lanka as at the date of the on-site visit (March 2006) or immediately thereafter. It describes and analyses those measures, and provides recommendations on how certain aspects of the system could be strengthened. It also sets out Sri Lanka's levels of compliance with the FATF 40+9 Recommendations (see the attached table on the Ratings of Compliance with the FATF Recommendations).[1]

2. Sri Lanka has only very recently passed legislation relating to ML. In fact, the two pieces of legislation – the Prevention of Money Laundering Act 2006 (PMLA) and Financial Transactions Reporting Act 2006 (FTRA) – only came into effect during the Evaluation Team's on-site visit in March 2006. Sri Lanka's AML/CFT regime is thus at a nascent stage and there has been no history of investigations or prosecutions of ML under the current legislation by which the extent of the problem could be judged in any comprehensive way. The Sri Lankan authorities have not yet undertaken a comprehensive risk assessment or analysis of ML or TF. There have been few instances of ML detected in Sri Lanka, and there is insufficient information on which to extrapolate as to common or significant methods or trends.

3. Given the very recent passage of the laws, the Government's primary focus now is on *effective implementation* of the new laws, including the promulgation of implementing regulations and the establishment of an operational financial intelligence unit (FIU) which is expected to be established and operational by mid 2006. Sri Lankan authorities indicated that consideration is being given at the highest political level to take every possible step to arrest ML and TF, and Sri Lanka has sought the assistance of international agencies and institutions to set up the FIU. The FIU was formally established by Order issued by His Excellency the President under the Financial Transactions Reporting Act No. 6 of 2006 on 23 March 2006 and is expected to be fully operational by mid-2006.

4. Terrorism has become major challenge in Sri Lanka. Tensions between the Sinhalese majority and Tamil separatists erupted into civil war in 1983. Tens of thousands have died in the conflict. After two decades of fighting, the Government and the Liberation Tigers of Tamil Eelam (LTTE) formalized a cease-fire in February 2002. At the time of the on-site visit, the Government and the LTTE had resumed peace talks, but tensions and the level of violence have recently increased. The Sri Lankan authorities indicated that the LTTE conducts major fund raising events in the guise of cultural or community projects, with front cover organizations being used for this purpose. Bearing in mind the domestic situation, there has therefore been a greater focus of terrorism and TF issues. Sri Lanka has enacted legislation relating to TF: the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 was certified in Parliament on 8 August 2005, and Sri Lanka is a party to a number of United Nations Conventions on terrorism.

5. The mainstream financial sector in Sri Lanka consists of the Central Bank of Sri Lanka (CBSL), banks, finance companies, insurance companies and intermediaries, including brokers, licensed primary dealers, stock brokers and stock dealers. Sri Lanka

[1] Also see the attached table on the Ratings of Compliance with the FATF Recommendations for an explanation of the compliance ratings (C, LC, PC and NC).

also has an active non-financial sector that includes casinos, the mining and jewellery sector, accountants and lawyers as well as real estate.

## 2 Legal System and Related Institutional Measures

6. Sri Lanka acceded to and signed the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention), but has not yet ratified, the United Nations Convention on Transnational Organized Crime (the Palermo Convention). In January 2006, Sri Lanka's Parliament enacted the PMLA, the purpose of which is to criminalize ML in accordance with both the Vienna and Palermo Conventions. The PMLA came into force on 6 March 2006. Section 3(1) of the PMLA creates two separate but overlapping ML offences involving (i) engaging directly or indirectly in any transaction in relation to any property which is derived or realized, directly or indirectly, from any unlawful activity or from the proceeds of any unlawful activity, and (ii) receiving, possessing, concealing, investing in, disposing of, or bringing into, and transferring out of, Sri Lanka any property which is derived or realized, directly or indirectly, from any unlawful activity or from the proceeds of such activity.

7. "Unlawful activity" is defined to include a range of serious offences, one of which is "an offence under any other law for the time being in force which is punishable by death or with imprisonment for a term of seven years or more." Hence, the PMLA contains a mixture of listed offences and a set threshold. Designated categories of offences, as defined in the FATF Recommendations, that are not included as "unlawful activity" for the purposes of ML include environmental crimes; smuggling; piracy; and insider trading and market manipulation and the definition of "unlawful activity" includes only Sri Lankan offences. Hence, where a foreign predicate offence generates proceeds of crime, a conviction for that foreign predicate offence would be required to convict someone in Sri Lanka for laundering those proceeds in Sri Lanka.

8. The ML offences in the PMLA apply to natural persons who know or have reason to believe that the property is the proceeds of unlawful activity. Either mental element ("know" or has "reason to believe") may be inferred from objective factual circumstances under the general principles of Sri Lankan criminal law. The Act also extends criminal liability to a body corporate including its directors and officers and to unincorporated bodies. The PMLA makes no distinction in imposing punitive consequences on natural or legal persons. The penalties for ML are: (i) a fine not less than the value of the property in respect of which the offence is committed and not more than three times the value; or (ii) rigorous imprisonment for a period of not less than five years and not exceeding 20 years; or (iii) both a fine and imprisonment. Sri Lanka should consider changing the penalty structure for money laundering to provide more dissuasive sanctions to permit a fine greater than the amount of the funds laundered.

9. Given the fact that the PMLA only came into force during the on-site visit, there are no statistics available on investigations, prosecutions and convictions. The Evaluation Team was advised by the police that there were no planned investigations for these offences at the time of the visit.

10. Sri Lanka signed the International Convention for the Suppression of Terrorist Financing in January 2000 and ratified it in September 2000. In 2001, shortly after the September 11 attacks in the United States, Sri Lanka issued UN Regulation No. 1 of 2001 and in August 2005 enacted the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005. Both of these instruments create TF offences: the first explicitly in response to UN Security Council Resolution 1373 and the second in order to implement the UN Terrorist Financing Convention. In general, the offences in both instruments reflect the terms of both UN instruments, although some requirements are

either not covered or inadequately covered in these enactments. In addition, there are some significant interface issues between the Act and the Regulation. There have been no investigations, prosecutions or convictions under the Regulation or the Act.

11. Sri Lanka does not have a Proceeds of Crime Act or other similar general mechanism to confiscate the proceeds of crime. However, there are targeted mechanisms to freeze and confiscate assets in relation to ML, terrorism and TF under the PMLA, the Prevention of Terrorism Act No. 48 of 1979, the Convention for the Suppression of Terrorist Financing Act No. 25 of 2005, and UN Regulation No. 1 of 2001. Sri Lanka does not have a civil forfeiture regime. There have been no freezing, seizing or confiscations of assets to date pursuant to the PMLA or the Convention for the Suppression of Terrorist Financing Act. Despite being issued over five years ago, there have also been no such actions taken under UN Regulation No. 1 of 2001 and there seems to be a general lack of knowledge among key agencies, such as the Police and Customs, in regard to this Regulation. The Evaluation Team was informed that the scheme for designation of terrorists and the freezing of their assets was put in place rather quickly following the attacks of September 11. It was acknowledged that the system needs improvement.

12. In relation to Sri Lanka's FIU, the FTRA generally incorporates all the requirements of FATF Recommendation 26, with the primary issue now being effective implementation of the recent legislative provisions. Sri Lanka's FIU had not been set up at the time of the on-site visit. While the FTRA sets out the powers and functions of the FIU, it does not itself actually establish the FIU. Rather, the definition section of the FTRA allows for the FIU to be established by Order (regulation). It was explained that this approach was taken because, at the time the FTR Bill was introduced into Parliament in late 2005, a final decision had not been made by the Government as to the location of the FIU. The Government subsequently decided to establish the FIU as an independent, multi-disciplinary body within the Central Bank of Sri Lanka (CBSL) comprising a variety of personnel from regulatory, competent authorities and law enforcement agencies. On 23 March 2006, the President of Sri Lanka issued an Order pursuant to the FTRA designating the FIU of the CBSL as the FIU for the purposes of the FTRA, and charging it with the implementation and administration of the provisions of the FTRA. The Evaluation Team recommends, inter alia, that the FIU is made operational as quickly as possible, is established under statute and given operational independence, is resourced appropriately with trained staff, and works with supervisors/regulators to formulate effective and consistent guidelines on identifying and reporting suspicious transactions.

13. The Sri Lankan Police Department is the organisation primarily responsible for investigating ML and FT offences. When established and operational, the FIU will have a role in coordinating the efforts of the relevant investigative agencies. In general, Sri Lankan investigators conducting investigations into serious and complex crimes regularly consult the Office of the Attorney-General which is the competent body to provide advice and guidance. The Police Department has yet to set up any investigation teams to specialize in the investigation of ML and proceeds of crime. The Counter Terrorist Unit had made no seizures of the proceeds of crime generated from terrorist activity. The Police Department advised that if appropriate, designated units in the Criminal Investigation Department would be set up to investigate ML and TF offences to enhance the enforcement capability in relation to ML and TF. The provisions in the Code of Criminal Procedure Code and the Penal Code contain the necessary provisions to empower law enforcement agencies when conducting investigations into the unlawful activity relating to ML and TF to compel production of documents, to search persons or premises and to seize documents and records held by financial institutions and other business or agency. Law enforcement agencies and all competent authorities should be

sufficiently funded, staffed and structured to ensure operational independence and effective performance of their functions.

14. There is a declaration system in place for cross border transportation of currency but with no mechanism to ascertain origin of the currency and its intended use in relation to money laundering or terrorist activity. There is no mechanism in place to maintain comprehensive statistics or to pass on information relating to declarations of cross border transportation to the FIU when established. The Evaluation Team has recommended that these deficiencies be rectified, and that the Customs Department enhance coordination with both domestic and foreign agencies.

### 3 Preventive Measures - Financial Institutions

15. The planned AML measures applicable to Sri Lanka's financial institutions are contained in the FTRA. Obligations under the FTRA will be applicable to "institutions", a term that includes persons and entities engaged in finance business and designated non-finance businesses. The definitions of "finance business" and "designated non-finance businesses" contained in the FTRA cover all the activities listed under "financial institutions" in the FATF 40 Recommendations.

16. The FTRA sets out customer identification, record-keeping, ongoing due diligence and suspicious transaction reporting requirements for institutions. As noted above, the FTRA was passed by Parliament on 6 March 2006 but is not yet fully in force, as all the required implementing regulations have yet to be drafted and promulgated. It should however be noted that on 23 March 2006, after the on-site visit, the President of Sri Lanka issued a Regulation (the Financial Transactions Reporting Regulations No. 1 of 2006) and an Order for the purposes of the section 6 of the FTRA, which set the threshold for reporting both cash transactions and EFTs at 500,000 rupees, or its equivalent in any foreign currency. (500,000 Sri Lankan rupees is roughly equivalent to US$5,000).

17. The FTRA allows a three-year phase-in period for the identification of existing customers at the time of coming into force of the provisions. The FTRA provides for the issuance of rules by the FIU to set out the specifics of the requirements, such as the types of identification documents, timing and thresholds. The transactions and circumstances that trigger the CDD requirements are consistent with those set out in FATF Recommendation 5. However, the CDD provisions are not yet fully in force and regulations have to be issued to set out some of the specifics of the CDD obligations. Although some of the institutions met by the Evaluation Team were aware that the FTRA would include mandatory customer due diligence provisions, considerable outreach and guidance will be required to ensure effective compliance in all sectors. There are some deficiencies and unspecified elements in the CDD framework, which need to be addressed and recommendations have been made in that regard. These relate, inter alia, to beneficial ownership, understanding the ownership and control of legal entities, and the purpose and intended nature of business relationships.

18. Foreign banks established in Sri Lanka have measures to identity and conduct enhanced due diligence on customers who are politically exposed persons (PEPs). There is however, no requirement for financial institutions to identify or take any specific measures in respect of PEPs, either domestic or foreign. Sri Lanka has signed and ratified, in March 2004, the United Nations Convention against Corruption, but has not implemented the elements of the Convention applicable to PEPs.

19. Representatives of the licensed commercial banks met by the Evaluation Team indicated that, as a matter of business practice, they verify that the foreign banks with

which they enter into a cross-border correspondent banking relationship with are reputable institutions. However, there are no requirements for due diligence or other procedures for financial institutions that enter into such relationships.

20. A significant proportion of financial transactions in Sri Lanka are still cash-based. Although growing, the use of new technologies, such as the Internet, in banking and other financial services is not widespread. Non-face-to-face transactions, although not prohibited by law, are therefore not common. There are however no enforceable requirements in respect of measures to prevent the misuse of technological developments in the financial sector and non-face-to face business relationships.

21. There is no prohibition in law for financial institutions in Sri Lanka to enter into a business relationship with a customer through an intermediary or other third party. However, financial institutions met by the Evaluation Team indicated that as a business practice they require their customers that are resident in Sri Lanka to be physically present when opening an account, and therefore would not initiate business relationships through third parties and introducers. The FTRA requires institutions to obtain and verify customer information, but does not specify whether these measures must in all cases be performed directly by the institution, as opposed to relying on another person or entity.

22. Generally, Sri Lanka's financial institution secrecy laws do not inhibit implementation of the FATF Recommendations. The passage and implementation of the FTRA will further clarify the situation. However, there are currently no clear pathways under which information can be readily shared between competent authorities either domestically or internationally.

23. Though not specifically provided in laws or enforceable regulations, the financial sector does maintain, generally, records for a period of six years. Further, the FTRA now also provides for maintenance and production of records of transactions by institutions. However the requirement that the records maintained should be sufficient to reconstruct the individual transactions has not been specifically provided for. To address the issues identified Sri Lanka should include obligations in law or regulations requiring financial institutions to maintain all necessary records on transactions for at least five years following completion of the transaction and to maintain records including account files and business correspondence for at least five years following the termination of an account or business relationship. The existence of exchange control in Sri Lanka makes it necessary for banks to obtain detailed information about the remitter in the case of outward cross-border wire transfers but only limited information is required to be obtained in respect of remitter in the case of inward remittances. There is no requirement under either a law or enforceable regulations that originator information must be included in the outward and inward wire transfers.

24. The FTRA does not lay down any requirement that financial institutions should pay special attention to complex, unusual large transactions or unusual pattern of transactions that have no apparent or visible economic or lawful purpose. Neither the CBSL nor any other regulator has issued any instruction or guidelines to the financial institution that they should pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose. The FTRA does not require financial institutions to give special attention to business relationships and transactions with persons (including legal persons and other financial institutions) from or in countries which do not or insufficiently apply the FATF Recommendations.

25. Section 7 of the FTRA requires that where a financial institution has reasonable grounds to suspect that any transaction or attempted transaction may be related to the

commission of any unlawful activity or any other criminal offence, it shall report within two days of forming such suspicion to the FIU. There is no threshold for STRs. The same procedure applies where a financial institution has information that it suspects may be relevant to an act preparatory to an offence under the Convention on the Suppression of Financing of Terrorism Act or to an investigation or prosecution of a person for an act constituting an unlawful activity or may otherwise be of assistance in the enforcement of the PMLA. The FTRA also provides for protection of the employee/director of an institution who is making the STR and ensures the confidentiality of employee making the report and provides for feedback to be made by the FIU to the reporting institutions. The reporting provisions of the FTRA are thus generally sound. However, with the FIU still to be established, reporting has not commenced. The effectiveness of reporting system is therefore yet to be established.

26. The FTRA provides that financial institutions are required to establish internal control procedures for complying with the AML/CFT requirements, including and independent compliance officer, independent audit functions, proper employee training and appropriate hiring procedures. The banks and non-banks appear to be well regulated from a prudential angle and internal control procedures exist for credit risk etc. However, attention needs to be given by the regulators that internal control measures have a specific focus on AML/CFT issues.

27. Among financial institutions in Sri Lanka, only some banks have a few foreign branches. The FTRA has clearly defined the scope of home and host country relations in connection with the AML/CFT requirements. Care needs to be exercised that respective supervisors establish systems that would ensure that the financial institutions having foreign presence scrupulously follow the provisions of the law.

28. While there are no express legislative provisions prohibiting shell banks in Sri Lanka, the bank licensing process effectively precludes the establishment and operation of shell banks in the country. All licensed commercial banks and licensed specialised banks in Sri Lanka have a physical presence in the country.

29. The Controller of Exchange issued, in December 2001, a circular to all commercial banks in respect of correspondent relationships with shell banks. The circular refers to guidance issued by the Department of Treasury of the United States, and notes that Commercial Banks should not maintain accounts for shell banks without the prior approval of the Controller of Exchange. In general, instructions issued by the Controller of Exchange are binding as they involve transactions between the resident and a non-resident upon which the Controller of Exchange could impose restrictions. Under section 51 of the Exchange Control Act, the failure to comply with a direction issued by Controller of Exchange constitutes an offence under the Act. That said, representatives of financial institutions met by the Evaluation Team were not aware of this circular, which indicates that the implementation of this provision may not be effective. Furthermore, the circular states that correspondent relationships with shell banks can be allowed by the Controller of Exchange. Finally, the circular does not include provisions requiring financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

30. There are three primary financial services regulators in Sri Lanka: the CBSL (which has various departments responsible for the regulation and supervision of various types of financial institutions), the Securities and Exchange Commission of Sri Lanka and the Insurance Board of Sri Lanka. The basic licensing and supervisory structure for banks, non-banks, securities market intermediaries and insurance companies exists. However, the respective supervisors have yet to integrate AML/CFT issues in their regular supervisory role and the fit and proper test is not adequate. There seems to be an

underlying belief that the establishment of the FIU will solve all the matters concerning AML/CFT, however when the FIU becomes operational there will be a need to clearly define the respective responsibilities of the FIU and of the industry regulator and to ensure that the FIU and supervisors work together to ensure effective AML/CFT regulation and supervision. All supervisors should integrate the AML/CFT requirements into their directions, regulations and guidance notes to the supervised institutions.

31. The financial sector regulators do not have specific powers to apply sanctions for breaches of AML/CFT requirements. However, as the regulated entities function under licenses issued by the regulators, they are required to follow the directions issued by the regulators and for non-compliance, the sanctions can extend to withdrawal of licence.

32. The Exchange Control Act prohibits any person in Sri Lanka from transferring funds outside the country, or from paying funds to a resident that is the beneficiary of an inbound funds transfer, except with the permission of the CBSL. General permission has been granted for outward remittances through commercial banks, if they are current account transactions (non capital). With regard to inbound transfers, they are permitted through commercial banks on the declaration of the source of the funds and the purpose of the remittance. Inbound remittances can also be received through large international money transfer services, which are not allowed to operate their own branches, but rather use licensed commercial banks as their agents. Although underground money remittance systems are illegal, they are a thriving sector in Sri Lanka. The absence of a legal money remittance sector has pushed a significant portion of the remittance flows underground, preventing any supervision and monitoring. This makes the money remitters very attractive in particular for the funding or terrorism.

## 4 Preventive Measures – Designated Non-Financial Businesses and Professions (DNFBPs)

33. All DNFBPs covered under FATF Recommendation 12 operate in Sri Lanka, including casinos, real estate firms and agents, gold bullion sellers and other dealers in other precious metals and stones, solicitors and barristers and accountants. Trust and company service providers do not operate as distinct entities from other professionals such as lawyers or accountants. There are currently no legislative or regulatory requirements or guidelines in force applicable to DNFBPs in respect of customer due diligence.

34. DNFBPs are included in the definition of "Institution" in the FTRA. There is no distinction in the application of the customer due diligence provision of the FTRA, to institutions that are engaged in "finance business" and those engaged in "designated non-finance business". The requirements will apply on a business relationship basis or a transaction basis, depending on the activities of the DNFBP. DNFBPs will be required, under the FTRA, to comply with some of the criteria under FATF Recommendation 5 on identity verification and ongoing due diligence, as well as the record-keeping standards set out in Recommendation 10, however the same deficiencies in the FTRA identified in relation to Recommendations 5 and 10 for financial institutions apply to DNFBPs. The FTRA does not however include requirements consistent with FATF Recommendations 6, 8, 9, or 11.

35. Unlike banks and finance companies, for which the KYC Guideline was issued by the CBSL in December 2001, there seems to be very little awareness within the DNFBP sector of the FTRA and its customer due diligence requirements. The authorities have not conducted consultation and outreach with these sectors in respect of the application of the FTRA. With respect to record-keeping, the FTRA provisions applicable to financial institutions also apply to DNFBPs. The FTRA requires every institution,

including DNFBPs, to maintain records of transactions and of correspondence relating to transactions and records of all reports furnished to the FIU for a period of six years from the date of transaction, correspondence or the furnishing of the report.

36. DNFBPs are subject to the suspicious transaction reporting requirements contained in the FTRA. Section 7 of the FTRA requires every institution to make suspicious transaction reports (STRs) to the FIU. Similarly, the protections for reporting and prohibitions against tipping off contained in the FTRA apply also to DNFBPs. However, as noted previously, the FIU and an effective STR regime is yet to be established in practice.

37. There are no existing guidelines or mechanisms for monitoring and ensuring compliance of DNFBPs with AML/CFT requirements. As the FTRA is not yet fully in force and the structure and role of the FIU have not yet been determined, there is no clear picture on how compliance with the FTRA would be enforced. It has not been decided whether it would be the role or the FIU or the regulators or SRO of the specific sectors. The shortcomings in legal arrangements, regulations and guidelines and their implementation noted above in relation to financial institutions apply also to the DNFBP sector. This situation is exacerbated by the fact that there are insufficient supervisors or SROs to facilitate implementation of FTRA across the various DNFBP sectors. Sri Lanka should either establish supervisors for each of the sectors or to upgrade the industry associations to SRO status and require them to issue necessary directions, regulations and guidance to their members and to ensure compliance through periodic examination. Even a very developed and efficient FIU cannot replace the sectoral supervisors who have an in-depth understanding of their domains and can play a very important preventative role.

38. The legal status of casinos does not appear to be clear in Sri Lanka. On the one hand, casinos are prohibited under the Gaming Ordinance. On the other hand, under the Betting and Gaming Levy Act, a levy is payable to the Ministry of Inland Revenue by a person carrying on business of gaming and large levies have in fact been paid by the seven casinos currently operating in Sri Lanka. Aside from collecting the levy, there is no actual supervision of casinos or ‘fit and proper’ checks of owners. This situation facilitates the ownership or control of casinos by elements of organized crime and the capability of authorities to enforce the requirements of the FTRA for casinos is doubtful.

## 5 Legal Persons and Arrangements & Non-Profit Organisations

39. In Sri Lanka business activities are carried on by companies and partnerships in addition to individuals. Companies incorporated in Sri Lanka are established under the Companies Act No. 17 of 1982 and they are required to file necessary papers with the Registrar of Companies. Companies incorporated outside Sri Lanka are required to register an address in Sri Lanka in relation to service of summons of etc. in relation to activities in Sri Lanka. All companies must maintain a register of past and present members which contains their names and addresses, nationality, principal occupations, numbers of shares held, the date of their share registration and the date of any transfer of their shares. Companies are also required to file annual returns every year with the Registrar which must contain the names of directors and secretaries as well as the number of shares held by each specifying any shares transferred from the last return. All changes of ownership of shares as well as change of any director of a company are required to be notified to the Registrar. This information is available to the general public and to competent authorities.

40. The Registrar may carry out an investigation or inquiry into the affairs of a company and the Companies Act grants wide ranging powers for this purpose. There are

a number of sanctions available to the Registrar or his inspectors to enforce their powers. In addition, the Registrar has wide powers to inquire into the ownership structure of a company.

41. Sri Lankan law does not permit bearer shares. Nor does it permit limited partnerships (whether incorporated or unincorporated). In terms of identification of natural persons, if two companies form a third private company, the Companies Act does not require the identification of the natural persons standing behind the forming companies – only particulars of the forming companies. Trust and company service providers (primarily chartered accountants and lawyers) are not required to obtain, verify and retain records of the beneficial ownership and control of legal persons.

42. With respect to legal persons, Sri Lanka recognizes express trusts as vehicles which can own assets and establish legal relationships with financial institutions. There are, however, no central registries to identify parties (settlor, trustee and beneficiary) to an express trust nor is there any general legal requirement to obtain, verify or retain information on the beneficial ownership and control of such trusts. Likewise, the newly enacted FTRA does not provide specific express trust customer due diligence for financial institutions when transacting business with those trusts.

43. Non-governmental organisations (NGOs) in Sri Lanka must be registered under the Voluntary Social Service Organizations (Registration and Supervision) Act 1980. NGOs are registered with the Ministry of Social Welfare and Social Services, which provides a certificate of registration. In February 2005, the Non-Governmental Sector Unit was created with the Ministry of Finance to streamline the NGO application process. The Unit evaluates applications and obtains the required clearance from the Ministry of Foreign Affairs and the Ministry of Defence.

44. In the months following the December 2004 tsunami, charitable donations from all over the world flowed into Sri Lanka. The funds were channelled through existing NGOs as well as a large number of new ones that established operations in Sri Lanka to provide relief to the victims and help reconstruction. The Controller of Exchange issued, in February and May 2005, operating instructions to commercial banks in respect of NGOs and that appropriate KYC measures should be performed with respect to the NGO and the signatories of the account. Although the authorities could track funds coming into the country to these special accounts, they admit having difficulties tracking the money coming out of the accounts and ensuring that it is in effect used to provide relief to tsunami victims.

45. Authorities in Sri Lanka have become aware that the existing NGO legislation is inadequate and that the government lacks the capability to ensure that funds are collected in an acceptable manner and are used in accordance with the NGOs' stated charitable objectives. Accordingly, Cabinet has established, in February 2006, an independent committee to review the NGO legislation and conduct public consultations on the issue.

## 6 National and International Co-operation

46. Sri Lanka has begun to put in place national mechanisms to address co-operation at both the operational level and, in particular in recent times, the policy level. There are however areas where co-operation and co-ordination could be further enhanced, especially as progress is made in establishment of the FIU and the implementation of the FTRA and PMLA generally.

47. In relation to operational co-operation and co-ordination, some mechanisms exist to co-ordinate the analysis, assessment and investigative capabilities of a range of agencies, but not specifically in relation to ML and TF. Sri Lankan authorities see the establishment of a multi-disciplinary FIU as a central 'clearing house' and centre of expertise in relation to ML and TF as playing a central part in both operational and policy coordination efforts in Sri Lanka. However, as the FIU is not yet operational, it still has not been determined precisely how the FIU will co-operate with the other domestic authorities in relation to operational and policy aspects concerning ML and TF matters. This matter is currently under consideration by Sri Lankan authorities.

48. Sri Lanka has recognised the importance of effective policy co-operation and the relevant Ministries and agencies worked together to get the Convention on Suppression of Terrorist Financing Act No.25 of 2005 enacted in August 2005 and the PMLA and FTRA enacted in March 2006. A Steering Committee for the FIU under the Ministry of Finance has very recently been set up to co-ordinate all concerned parties and oversee the establishment of the FIU office and related issues and play an advisory role in this regard. There is however significant scope to improve the level of co-operation and co-ordination between all relevant law enforcement agencies and also to enhance co-ordination at the policy level, possibly through the establishment of a formal national co-ordination mechanism, building on the recently established Steering Committee for the FIU, to include all relevant departments and agencies.

49. The Sri Lankan mutual legal assistance framework is contained primarily in the Mutual Assistance in Criminal Matters Act, No. 25 of 2002 (MACMA) but also in the PMLA and Convention on the Suppression of Terrorist Financing Act so far as the former is amended by those two Acts. The Secretary of Justice is designated the "central authority" under the MACMA. The MACMA allows Sri Lanka to provide a wide range of legal assistance. The PMLA and the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 specifically provide that the provisions of the MACMA apply to ML and TF offences respectively. Requests for assistance must be made in a specified format and accompanied by documentation as required by the central authority. Requests are processed as quickly as possible but completion times vary with the complexity and nature of the requests. There is no set time frame in statute or average time to complete such requests. There is no departmental guidance or policy on handling or prioritizing mutual legal assistance requests and comprehensive mutual legal assistance statistics are not maintained.

50. Under the Extradition Act No. 8 of 1977, extradition can be provided by Sri Lanka to Commonwealth countries specified by gazetted order of the Minister of Foreign Affairs (the central authority). Non-Commonwealth countries require a treaty or agreement which the Minister must also gazette. ML and TF (under the Convention on the Suppression of Terrorist Financing Act) are extraditable offences under the Extradition Act. However the list of extraditable offences in the Extradition Act does not include all of the ML predicate offences listed in the PMLA as "unlawful activity"; nor does it contain a penalty threshold similar to that Act. Moreover, TF offences under UN Regulation No. 1 are not extraditable. In addition, because of the lack of definition of the meaning of "funds" in the Convention Act there could be difficult issues arising in extradition matters around dual criminality. The Secretary for Foreign Affairs indicated that to date there have been no requests of Sri Lanka for extradition relating to TF nor has Sri Lanka made such requests. Comprehensive extradition statistics are not maintained.

51. Although there are provisions in the FTRA and PMLA governing the arrangements and policy concerning international cooperation, the Evaluation Team was unable to examine the effectiveness of these provisions given the very recent passage of the two Acts.

52. The Police Department is able to co-operate through normal police to police information exchange channels. Sri Lanka is a member of Interpol. According to the statistics provided during the on-site visit, in 2005, Sri Lanka received 209 requests for Interpol assistance from foreign countries which included the location of persons, providing information on terrorism and human smuggling etc. A total of 207 replies were sent. Sri Lanka sent 138 requests for assistance to other member countries during the same period and to date had received replies to 101 requests. There is no general restriction imposed on the assistance that can be provided to other countries in criminal investigations.

## 7 Other issues

53. Sri Lanka emphasised to the Evaluation Team that it requires assistance from the international community to ensure the cessation of the violence by the LTTE in Sri Lanka. In order to curtail the activities of the LTTE, Sri Lanka recognises that it is necessary to put in place effective measures in respect of AML/CFT. Sri Lanka again stressed the importance of the provision of technical assistance in this regard by donors. The Evaluation Team was pleased to note the coordinated and cooperative approach to technical assistance already being taken in Sri Lanka, both by the Sri Lankan authorities and by the AML/CFT donor community.

# MUTUAL EVALUATION REPORT

# 1 GENERAL

## 1.1 GENERAL INFORMATION ON SRI LANKA

1. Sri Lanka is a relatively small open economy with a land area of 65,610 sq. km. and a population of 19.7 million in 2005. The country's location below the southern tip of India has resulted in it being a major trading port for centuries. In terms of ethnicity, Sinhalese account for approximately 74 per cent of the country's population. The Tamils form 18 per cent of the country's population whilst the Moors (Muslims), Malays and others form 8 per cent collectively. The official languages are Sinhalese and Tamil. English is the accepted as business language.

2. The Sinhalese arrived in Sri Lanka late in the 6th century B.C. Buddhism was introduced beginning in about the third century B.C., and a great civilization developed at the cities of Anuradhapura (from circa 200 B.C. to circa A.D. 1000) and Polonnaruwa (from about 1070 to 1200). In the 14th century, a south Indian dynasty seized power in the north and established a Tamil kingdom. Occupied by the Portuguese in the 16th century and by the Dutch in the 17th century, the island was ceded to the British in 1796, became a crown colony in 1802, and was united under British rule by 1815. As Ceylon, it became independent in 1948; its name was changed to Sri Lanka in 1972.

3. Sri Lanka's current constitution was adopted in August 1978. Under the Constitution, Legislative power in Sri Lanka is exercised by a Parliament, elected by universal franchise on proportional representation basis. Sri Lanka has a unicameral Parliament of 225 seats, with members elected by popular vote on the basis of a modified proportional representation system by district to serve six-year terms.

4. The Head of State of the Republic of Sri Lanka is the President, who is elected by the people and holds office for a period of six years. The President is the Head of the Executive, the Head of the Government, and the Commander in Chief of the Armed Forces. The Constitution confers upon an elected President the power, inter alia, to appoint the Prime Minister and other Ministers of the Cabinet of Ministers, the Chief Justice and other Judges of the Supreme Court. The Cabinet is appointed by the President in consultation with the prime minister.

5. Sri Lanka's legal system is a mixture of English common law, Roman-Dutch, Muslim, Kandyan, and customary law. Thesawalamai law applies to persons living in the Jaffna peninsula or who have the intention of reverting to live in the Jaffna peninsula. The judicial branch consists of the Supreme Court of Sri Lanka (the highest court in the country); the Court of Appeal; the High Court; District Courts; Magistrates' Courts and Primary Courts. Judges for the Supreme Court and Court of Appeals are appointed by the President.

6. Tensions between the Sinhalese majority and Tamil separatists erupted into civil war in 1983. Tens of thousands have died in the conflict. After two decades of fighting, the Government and the Liberation Tigers of Tamil Eelam (LTTE) formalized a cease-fire in February 2002, with Norway brokering peace negotiations. At the time of the on-site visit, the Government and the LTTE had resumed peace talks, but tensions and level of violence have very again increased since April 2006.

7. Sri Lanka has made considerable economic progress maintaining an average growth rate of 5 per cent during the last three decades, despite a series of domestic and

international shocks including the civil war in the North and the East of Sri Lanka since 1983. .The adoption of a market-oriented economic system and development strategy in 1977 and the subsequent reforms and liberalization measures undertaken by the Government in recent years have enhanced the long-term growth prospects and resilience of the Sri Lankan economy. In 2005, real gross domestic product (GDP) growth increased to 6.0% from 5.4% in 2004, and stood at US$ 23.5 billion. In terms of per capita income, Sri Lanka ranks the second highest in the South Asian region with GDP per capita of US$1,197 in 2005 compared to US$1030 in 2004

8. Since Sri Lanka gained independence in 1948, the structure of the economy is transforming from an agricultural economy to a more service- based economy. The agriculture sector share in the GDP has fallen gradually from over 40 percent since independence to 17 percent in 2005. Industrial sector share has increased gradually to around 27 percent, while the services sector share had increased to 56 percent by 2004. The services sector has now become the key-driving factor of the economy as a result of the economic liberalization measures and the emergence of new growth areas, such as tourism, port services, financial services, information technology and telecommunications.

9. Being a small open economy, the external sector plays an important part in the Sri Lankan economy. Exports of goods and services have grown in importance since independence and account for over one third of GDP. The composition of exports has diversified shifting high relative share from agricultural goods to industrial products. Strong growth in private transfers, including worker remittances and tourism earnings has helped finance a large part of the trade deficit. The Government accepted Article VIII status of the International Monetary Fund in 1993 and adopted a floating exchange rate system in January 2001, two major steps in the liberalization of the foreign exchange regime. Gross official reserves and total external reserves stood at US$2,735 million and US$4,200 million at the end of 2005. The Rupee-US dollar average exchange rate was Rs.102.12 per US dollar at the end of 2005.

10. Within the financial sector, banking sector dominates, accounting for about 70 per cent of the financial assets of the country. Financial assets to GDP ratio stood at 133 per cent in 2005. There are 22 commercial banks with a branch network of 1,405 in 2005. There are about 60 other non-bank financial institutions such as insurance, finance companies, merchant banks and unit trust. At end 2005, the Colombo Stock Exchange had 239 listed companies, representing 20 business sectors, with a market capitalization of approximately Rs.584 billion (approximately 24% of the country's GDP). Sri Lanka has a large tradable government securities market with total outstanding government securities consisting of Treasury bills and bonds) amounting to approximately Rs.990 billion as of December 31, 2005.

11. In terms of key health indicators, Sri Lanka ranks above many developing countries and is on par with many developed countries, mainly due to the free health care services and other welfare programs implemented by the Government since independence. Sri Lanka's Human Development Index of 0.751 ranks Sri Lanka at 93 among 177 countries.

### 1.2 GENERAL SITUATION OF MONEY LAUNDERING AND FINANCING OF TERRORISM

12. Sri Lanka has only very recently passed legislation relating to money laundering. In fact, the two pieces of legislation – the Prevention of Money Laundering Act No. 5 Of 2006 (the PMLA) and Financial Transactions Reporting Act No. 6 of 2006 (FTRA) – were

only formally signed off by the Speaker of the Sri Lankan Parliament during the Evaluation Team's on-site visit in March 2006.

13. Sri Lanka's AML/CFT regime is thus at a nascent stage and there has been no history of investigations or prosecutions of money laundering under the current legislation by which the extent of the problem could be judged in any comprehensive way. The Sri Lankan authorities have not yet undertaken a comprehensive risk assessment or analysis of money laundering or the financing of terrorism.

14. There are currently no enforceable customer due diligence requirements applicable to all financial institutions in Sri Lanka. In December 2001, however, the CBSL issued a Guideline on Know Your Customer and Due Diligence to licensed commercial banks and licensed specialised banks. Finance Companies were also advised to implement KYC procedures for customers that purchase certificates of deposits. The Guideline provides recommendations but it is not mandatory.

15. In its Jurisdiction Report to the APG's 2005 Typologies Workshop, the Sri Lankan authorities advised that there had been a few instances of money laundering the authorities had detected and taken action to prevent, including:

- prior to 1995, there was provision in the Banking Act to enable persons to maintain secret numbered accounts. During this time, an individual attempted a money laundering transaction by using funds in a secret numbered account to purchase bank drafts and instruments on submission of forged documents claiming that such foreign exchange were to be utilized for travel purposes. After obtaining the authority to use foreign exchange this individual had, without using them for the authorised purposes, credited the monies to an off-shore account in order to make outward remittances to various parties abroad. On detection of this case, action was initiated under the provisions of the Exchange Control Act to prosecute the offenders. In 1995, the Banking Act was amended to repeal the provisions relating to Secret Numbered Accounts and there is now no facility to maintain secret numbered accounts;
- another instance of money laundering was discovered when a considerable amount of money was brought into the country under the guise of an advance payment for an export. The party who received the money attempted to launder it by making withdrawals from the account without making any physical export. After detection of this case, part of the money involved in the laundering was frozen and the matter referred to Sri Lankan Police Force for investigation;
- in another case a person attempted to bring into Sri Lanka a considerable sum of money claiming that part of the money was for investment in Sri Lanka and the balance to be donated to a NGO for social development work. The attempt made by the Exchange Control Department of the Central Bank of Sri Lanka to ascertain the source of funds was not successful and the matter was referred to the Police Force which commenced investigations. However, the suspect left the country prior to the completion of the investigation.

16. Other possible methods of money laundering mentioned by Sri Lankan authorities in their 2005 Jurisdiction Report were:

- use of cash-intensive establishments such as restaurants, hotels, casinos, and construction companies as front companies. Illegal profits are co-mingled with legitimate income in the placement and layering stages of money laundering;
- the over- or under-invoicing of import/export transactions could be used as a method of money laundering by using the difference to be transferred for illegal purposes, in

addition to attempting to circumvent Sri Lanka's foreign exchange laws and to evade the payment of taxes and duties;

- acquisition of companies on the verge of bankruptcy to launder money by injection of funds and showing profits thereafter; and
- the use of certificates of deposit issued by banks.

17. However, there is insufficient information at this stage to indicate whether the above instances constitute common or significant money laundering methods or trends in Sri Lanka.

18. Bearing in mind the domestic situation, there has however been a somewhat greater focus of terrorism and terrorist financing issues. Sri Lanka has enacted legislation relating to terrorist financing. The Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 was certified in Parliament on 8 August 2005.

19. Sri Lanka is a party to the following conventions.

i. The Convention for the Suppression of Unlawful Seizure of Aircraft, done at the Hague on December 16, 1970.
ii. The Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, done at Montreal on September 23, 1971.
iii. The Convention on the Prevention and punishment of crimes against internationally protected persons, including Diplomatic Agents, adopted by the General Assembly of the United Nations on December 14, 1973.
iv. The International Convention against the Taking of Hostages, adopted by the General Assembly of the United Nations on December 17,1979.
v. The Convention of Physical Protection of Nuclear Material, adopted at Vienna on March 3, 1980.
vi. Protocol for the Suppression of Unlawful Acts of Violence at Airports serving International Civil Aviation, Supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, done at Montreal on February 24, 1988.
vii. Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation, done at Rome on March 10, 1988.
viii. Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf, done at Rome on March 10, 1988.
ix. International Convention for the Suppression of Terrorist Bombings, adopted by the General Assembly of the Untied Nations on December 15, 1997.

20. Terrorism has become major challenge in Sri Lanka. The Sri Lankan Government informed the Evaluation Team that the LTTE conducts major fund raising events in the guise of cultural or community projects. Front cover organizations are extensively being used for this purpose. Individual donations are also highly encouraged.

21. According to Sri Lankan authorities, the most recent example of this method of fund raising by the LTTE related to the tsunami that killed over 40,000 people around the coastline of the island in late 2004. The Sri Lankan authorities indicated that the LTTE's front-cover arm, the Tamil Rehabilitation Organization (TRO), is heavily engaged in collecting funds and donations in the guise of reconstruction and rehabilitation activities of the tsunami affected North and the East. Sri Lankan authorities state that a major proportion, probably over 50%, of these funds is diverted to the operational coffers of the LTTE. The authorities also estimate that one-third of the Government's daily grants to the victims (approximately US$5 per day) in LTTE-held areas is diverted to the LTTE's accounts using indirect means.

22. The Sri Lankan authorities also advised that several terrorist groups raise funds through illegal activities such as drug trafficking, extortion, kidnapping, gun running, human smuggling, money laundering and counterfeiting. Funds collected outside of Sri Lanka are transferred by various means, including alternative remittance systems (Hawala) and use of the formal banking system through front-cover organizations. The major financial institutions are helpless when apparently legal transactions are taking place to support terrorist organizations through these front-cover organizations. More recent bank technologies such as ATM Cards and e-transactions have also been utilised.

### 1.3 OVERVIEW OF THE FINANCIAL SECTOR AND DNFBP

23. The financial sector in Sri Lanka consists of the Central Bank of Sri Lanka (CBSL), banks, finance companies, insurance companies and intermediaries, including brokers, licensed primary dealers, stock brokers and stock dealers.

24. Sri Lanka has a dynamic banking system. There are two categories of banks namely 'licensed commercial banks', which are authorised to operate current accounts and a full range of foreign exchange operations for their customers, and 'licensed specialised banks' (LSBs), which conduct specialised banking business but are not permitted to operate current accounts and are not authorised dealers in foreign exchange. Both types of banks are required to obtain a license from the Monetary Board of the CBSL (the monetary authority of the country) prior to the commencement of business.

25. The LSBs are not permitted to carry on full range of foreign exchange activities or maintain current accounts. Section 76D(3) of the Banking Act specifies that the Monetary Board may authorise a LSB which satisfies the requirements prescribed by regulations made by the Minister to carry on offshore banking business in accordance with such offshore banking scheme formulated for LSBs by the Monetary Board .

26. In addition to the above distinction, Sri Lanka has two types of banks in operation, namely (i) branches of foreign banks which conduct their activities in the name of banks registered outside Sri Lanka, and (ii) locally incorporated banks registered under the Companies Act No. 17 of 1982. Not all locally incorporated banks are incorporated under the Companies Act, since some are established by statute. Two commercial banks and four specialised banks have been established by statute. Further, the six Regional Development Banks have also been established under a statute, the Regional Development Banks Act. The particulars of locally incorporated banks and the foreign banks are follows:

| **Number of banking institutions in Sri Lanka** | |
|---|---|
| *1. Licensed commercial banks* | |
| Locally incorporated | 11 |
| Branches of banks incorporated outside Sri Lanka | 12 |
| Sub -total | 23 |
| *2. Licensed specialised banks* | 15 |
| **Total** | **38** |

27. In addition to the banks, there are 28 registered finance companies operating in Sri Lanka licensed by the Monetary Board of the CBSL under the Finance Companies Act No. 78 of 1988. Finance companies are supervised by the Department of Supervision of Non-Bank Financial Institutions of CBSL.

28. Government Securities issued by the CBSL as part of its activities of the management of the Public Debt of Sri Lanka are sold to the public through 'Licensed Primary Dealer's who are registered and supervised by the Public Debt Department of the CBSL.

29. The Colombo Stock Exchange (CSE) is a company limited by guarantee, and established under the Companies Act No. 17 of 1982. The CSE took over the Stock Market in 1985 from the Colombo Share Brokers Association. The CSE has a membership of 18 institutions, 15 of whom are licensed to operate as Stock Brokers and 03 of whom are licensed to operate as Stock Dealers. The Exchange has 236 companies listed as at May 2006 representing 20 business sectors with a market capitalization of 672.5 billion Sri Lankan rupees. The CSE is regulated by the Securities and Exchange Commission of Sri Lanka.

30. Insurance services are provided by 16 insurance companies. The insurance industry is regulated and supervised in terms of the proviso of the Regulation of Insurance Industry Act No. 43 of 2000 under which the Insurance Board of Sri Lanka (IBSL) has been established.

31. Only commercial banks or money transfer agencies use licensed commercial banks as their agents are permitted to offer remittance services in Sri Lanka. Other forms of remittance are illegal, although there is a thriving informal alternative remittance 'hawala' sector in Sri Lanka. Hawala is widely used for inward remittance from overseas Sri Lankan workers. Due to strict currency controls, underground 'hawala' remitters underground money remitters can be an attractive option for outbound remittances. Sri Lanka authorities indicate significant challenges with enforcing the prohibition on Hawala in the country.

32. Those transfer agencies offering remittance services using banks as agents are not directly regulated or supervised for AML/CFT.

33. Sri Lanka also has a well developed non-financial sector that includes casinos, the mining and jewellery sector, accountants and lawyers as well as real estate.

34. There are currently seven large casinos operating in Sri Lanka which, despite an unclear legal status, pay an annual levy to the Inland Revenue Department. These casinos are not currently subject to AML/CFT controls.

35. In September 1998, Sri Lanka decided to liberalise trade in gold, other precious metals and gems to develop gem and jewellery industry in the country by granting exemption from taxes, duties and other levies. Since September 1999, the purchase and sale of gold in Sri Lanka is freely permitted, while the importation or exportation of gold is also permitted subject only to declaration to the Department of Sri Lanka Customs. Several mines of precious stones, such as sapphires and emeralds, are in operation in Sri Lanka, which also has a developed cutting and polishing sector, as well as a wholesale and retail segment of the jewellery sector. The Sri Lanka Gems and Jewellery Association, the trade association for the industry, has 350 members. Only banks are allowed by law to sell and purchase gold bullion.

36. Accountants exercise in Sri Lanka under one of three designations, Chartered Accountant, Management Accountant, or Certified Accountant. There are 2254 Chartered Accountants and 2345 Certified Accountants. Only chartered accountants provide audit services. Legal professionals, solicitors, and barristers in Sri Lanka are members of the Bar Association of Sri Lanka but are ultimately regulated by the Supreme Court. There are 16,813 lawyers enrolled by the Supreme Court of Sri Lanka.

Accountants and legal professionals can exercise as sole practitioners or as part of an accounting or law firm, or work for a corporation or the government. Trust and company service providers do not operate as distinct entities from other professionals such as lawyers or accountants.

37. Real estate agents operate in Sri Lanka but are not licensed, nor are they subject to any regulatory or supervisory regime.

38. Both local and international non-governmental organisations (NGOs) are very active in Sri Lanka, in particular in the areas that are most affected by conflict with the LTTE. They support projects in the areas of poverty relief, health care and education Also, due to the adverse impact on the economy by the 2004 Tsunami disaster there have been an increasing number of NGOs working in Sri Lanka which have received considerable funds from sources outside the country. NGOs are registered with the Ministry of Social Welfare and Social Services, although the Ministry of Finance also plays a major role in the registration process The National NGO Secretariat's website provides a list of about 1000 NGOs registered at the national level. Authorities have observed an increase in the flow funds to NGOs into Sri Lanka, of which the source of funds have not been investigated. Recently, a survey was done by the CBSL on the debits and credits to NGO Accounts as requested by the Ministry of Finance and the global results were released to the public.

### 1.4 OVERVIEW OF COMMERCIAL LAWS AND MECHANISMS GOVERNING LEGAL PERSONS AND ARRANGEMENTS

39. In Sri Lanka business activities are carried on by companies and partnerships in addition to individuals. Companies incorporated in Sri Lanka are established under the Companies Act No. 17 of 1982 and they are required to file necessary papers with the Registrar of Companies. Companies incorporated outside Sri Lanka are required to register an address in Sri Lanka in relation to service of summons of etc. in relation to activities in Sri Lanka.

40. The Registrar of Companies administers the Companies Act, the Societies Act, the Public Contracts Act and the Theetus Ordinance (or "Chit Funds"). All companies in Sri Lanka must register under the Companies Act No. 17 of 1982.

41. There are three kinds of companies: private companies; public companies and people's companies. Regardless of the type of company, all companies must centrally register with the Registrar of Companies. A number of documents are required including a Memorandum and Articles of Association. The Registrar examines these documents and approves them in the form and content required under the Companies Act. If he approves them, he may also approve incorporation.

42. All companies must maintain a register of past and present members which contains their names and addresses, nationality, principal occupations, numbers of shares held, the date of their share registration and the date of any transfer of their shares.

43. Companies are also required to file annual returns every year with the Registrar which must contain the names of directors and secretaries as well as the number of shares held by each specifying any shares transferred from the last return.

44. All changes of ownership of shares as well as change of any director of a company whether due to appointment or resignation are required to be notified to the Registrar of Companies. This information is available to the general public.

### 1.5 OVERVIEW OF STRATEGY TO PREVENT MONEY LAUNDERING AND TERRORIST FINANCING

#### *a. AML/CFT Strategies and Priorities*

45. As noted above, the Government has very recently passed legislation to combat terrorism and money laundering. Passage of the PMLA and the FTRA is a very significant development in the development of Sri Lanka's AML/CFT system; given the very recent passage of the laws, the government's the primary focus now is on *effective implementation* of the laws, including the promulgation of implementing regulations and the establishment of an operational FIU.

46. Sri Lankan authorities indicated that due consideration is being given at the highest political level to take every possible step to arrest money laundering and terrorist financing. The government has sought the assistance of international agencies and bilateral donors, and foreign technical assistance has been offered to set up the FIU. The FIU, which the Government has decided will operate from the CBSL, is expected to be established by mid to late 2006[2].

47. Prior to these recent developments, the CBSL had issued non-mandatory Guidelines on Customer Due Diligence to all banks in December 2001. The Guidelines set out minimum criteria to be adopted by banks, including developing internal policy and procedures for customer due diligence, keeping records of customer identification as well as review by internal auditor of compliance with banks' policies. Again as noted above, the provisions which enabled the maintenance of numbers accounts were repealed by the Banking Amendment Act No.33 of 1995.

48. It should also be noted that in October 2001, shortly after the September 11 attacks, Sri Lanka issued UN Regulation No. 1 of 2001, which created terrorist financing offences in response to UN Security Council Resolution 1373. As noted in section 2.2 of this report, however, there are some discrepancies between the UN Regulation of 2001 and the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 which was subsequently passed in August 2005. There have been no investigations, prosecutions or convictions under UN Regulation No. 1 of 2001

49. It is also relevant to note that the CBSL has issued orders requesting banks to block any payments to non-residents who are listed as terrorists and terrorist organizations under UN Security Council Resolutions. The Exchange Control Act empowers the CBSL to issue such orders and banks are required to report to the Director of the Exchange Control Department of the CBSL. The banks' compliance with the orders is reviewed by on-site inspections by the Bank Supervision Department of the CBSL as part of general compliance with laws and regulations. Thus far, there are no records of blocked assets/accounts.

50. It should also be noted that foreign exchange business is subject to control by the Exchange Control Act and required permits by the CBSL. Only authorised

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[2] With effect from 1 June 2006, the Government appointed a Chief Executive Officer (CEO) for the FIU. The FIU has an Advisory Board, chaired by the Secretary, Ministry of Finance and the Head of the FIU will be reporting to the Ministry of Finance through the Governor of the Central Bank of Sri Lanka.

commercial banks and dealers (e.g. money changers) are allowed foreign exchange businesses. Receipt of overseas remittance is also subject to the Exchange Control Act.

### *b. The institutional framework for combating money laundering and terrorist financing*

#### Ministries

51. The CBSL, the Ministry of Finance, Ministry of Justice, Judicial Reforms and National Integration, and the Ministry of Foreign Affairs, along with the officials of the Police Department which comes under the purview of the Ministry of Defence, are the most relevant agencies in Sri Lanka for combating money laundering and terrorist financing. These agencies were also involved in the drafting of the PMLA and FTRA, which was done with the aid of a legal adviser under technical assistance from the International Monetary Fund.

52. The following Ministries, agencies and institutions are involved in decision making relating to AML/CFT policy formulation in Sri Lanka.

- Ministry of Finance & Planning: the Minister of Finance is the Minister under whose purview the subject of money laundering will be assigned under the provisions of the Assignment of Powers and Functions under the Constitution of Sri Lanka.
- Ministry of Justice & Judicial Reforms, under whose purview the Attorney-General and the Court Structure of the country function, attends to the matters relating to implementation of policies, plans and programmes in respect of justice and law reforms, and the administration of Courts of Justice not otherwise assigned to any other person under the Constitution.
- Ministry of Defence, Public Security, Law & Order. The Police Department and all other law enforcement authorities relating to money laundering and terrorist financing come under the purview of the Ministry of Defence. Implementation of policies, plans and programmes in respect of defence, public security, law and order, defence and internal security of Sri Lanka, prevention and control of dangerous drugs, prevention of terrorism, maintenance of law and order come under the Ministry's purview. Further, this Ministry makes the policy decisions relating to policy formulation in respect of the registration of natural persons. In Sri Lanka all natural persons who are over 18 years of age are issued National Identity Cards by the Commissioner of Registrar of Persons.
- Ministry of Foreign Affairs. All mutual assistance agreements with other countries as well as the ratification of the international conventions are subject matters under the purview of this Ministry.
- Ministry of Trade and Commerce. This Ministry determines the policy relating to registration of companies and other legal persons.

#### Criminal justice and operational agencies

53. The following criminal justice and operational agencies have or will have a role to play in the implementation of Sri Lanka's AML/CFT system:

- the Financial Intelligence Unit (FIU). The FIU is being established within the CBSL, under Regulations issued under the FTRA on 23 March 2006, and the initial process for making it fully operational has begun.

- the Police Department (in particular the Criminal Investigation Department), the National Dangerous Drugs Control Board, and the National Intelligence Bureau are responsible for the investigation of money laundering and terrorist financing activities and predicate offences.
- the Exchange Control Department of the CBSL implements Sri Lanka's exchange control policy and law
- the Commission to Investigate Allegations of Corruption and Bribery implements the provision of the law relating to bribery and corruption.
- the Customs Department, which is established under the purview of the Ministry of Finance, implements the provisions of the Customs Ordinance. It has the power to confiscate goods in the event of the contravention of the provisions of the law.
- the Inland Revenue Department, established under the Ministry of Finance, is responsible for the collection of revenue under the provisions of Sri Lanka's tax legislation.
- The National Disaster Management Council is responsible for the coordination and management of activities pertaining to natural and man made disasters. This is relevant in relation to Sri Lanka's large NGO/NPO sector.

**Financial sector institutions**

54. The following agencies have a role to play in the supervision of Sri Lanka's financial sector:

- The CBSL regulates and supervises the licensed commercial banks, licensed specialized banks and non-banking financial institutions with a view to ensuring the safety and soundness of banks and banking system and safeguarding the interests of depositors. This function, governed mainly by the Banking Act, the Monetary Law Act, the Finance Companies Act, the Finance Leasing Act, is carried out through the issue of directions under the statutes, issue of prudential requirements and guidelines, granting approval for licensing, establishing and closing of banks, branches and other business outlet of banks, off-site examinations of banks, enforcement of regulatory actions and resolution of weak bank in terms of statutes. Directions and prudential requirements mainly relate to the control and mitigation of many risks such as those relating to capital, liquidity, large exposures, open positions, share ownership in banks, investment in shares by banks, income recognition and provisioning for bad and doubtful debts, related party transactions, acquisition of immovable property, disclosure of quarterly and annual financial statements, preparation of annual accounts and the audit of banks, corporate governance and adherence to know-your-customer rules. Procedures have been laid down in the Banking Act, 1988 under which CBSL can cancel the license of a bank. Within the CBSL:

  - the Bank Supervision Department of the CBSL is responsible for the administration of the provisions of the Banking Act, which imposes responsibilities relating to licensing and the supervision of commercial banks and licensed specialised banks;
  - the Department of Supervision of Non-Bank Financial Institutions (DSNBFI) of the CBSL is responsible for the administration of the provisions of the Finance Companies Act, which imposes responsibilities relating to licensing and the supervision of all deposit taking companies other than institutions licensed as commercial banks and licensed specialised banks. Several directions have been issued by DSNBFI on capital adequacy, lending, investments, deposits,

transactions with related parties, single borrower limit, and preparation and presentation of financial information for public awareness. DSNBFI follows off-site and on-site supervision practices. Both, off-site and on-site supervision are carried out. Further, DSNBFI is empowered to supervise the finance leasing establishments registered with CBSL under Finance Leasing Act, 2000;

The Finance Companies Act exempts co-operative societies registered under the Co-operative Societies Law from the registration and licensing requirements under the Act. In addition, building societies registered under the National Housing Act and any legitimate non-profit oriented institution which is permitted in writing by the Monetary Board of CBSL to accept deposits from its members do not come under the purview of the Act.

The Finance Companies Act requires all registered finance companies to publish the financial statements within 6 months after the close of a financial year. In addition, under a rule issued by the Monetary Board, registered finance companies are required to publish certain financial information in the advertisements issued for soliciting deposits.

- the Exchange Control Department of the CBSL supervises money changers.

- the Securities and Exchange Commission of Sri Lanka is the statutory body established under the Ministry of Finance which regulates the activities of the capital market of the country. The Commission has powers to give general or specific directions to stock exchanges, stockbrokers, managing companies, trustees of unit trust or a market intermediary from time to time. The Commission also has powers to carry out inspection of the activities of the above entities and to require them to submit audited balance sheets. Finally, the Commission has powers to cancel the licences issued to the above entities. The Commission's powers are required to be carried out pursuant to the discharge of the duties and responsibilities with which the SEC is vested under the Security and exchange Commission Act.
- the Insurance Board of Sri Lanka is a statutory body under the purview of the Ministry of Finance which regulates the insurance industry in Sri Lanka. The mandate of the Board is to ensure that insurance business in Sri Lanka is carried on with integrity and in a professional and prudent manner with a view to safeguarding the interests of the policy-holders. The Board is responsible for the licensing of insurance companies and insurance brokers. The Supervision Division of the IBSL monitors the financial and operational performance of all Insurance Companies and Insurance Broking Companies; ensures that Insurance and Insurance broking Companies maintain financial stability; employ competent staff to conduct business; conduct on-site routine inspection; conducts off-site inspections based on quarterly returns, annual returns and audited accounts and also insures that there is fairness and level playing field in the insurance market. Where the Insurance Board believes that the business of an insurer are being conducted in a manner likely to be detrimental to the public or national interest or the interest of the policy holders or prejudicial to the interests of the insurer, the Board may issue directions to the insurer as it deems necessary. Failure to comply with directions of the Insurance Board can result in the suspension or cancellation of a registration or license.
- the Centre for Non-Governmental Sector, which is a department of the Ministry of Finance and Planning, is responsible for the investigation of the activities of Non-Governmental Organisations. Further, the Registrar of Non Governmental Organisations, Ministry of Social Services & Social Welfare is irresponsible for registering and supervising NGOs.

- the Sri Lanka Accounting and Auditing Standards Monitoring Board sets out the policy relating to the maintenance of proper auditing and accounting standards.
- The Department of External Resources of the Ministry of Finance is responsible for maintenance of all records relating to assistance received by the Government and its statutory bodies and agencies of the Government.
- The National Council for Economic Development coordinates all work relating to policy formulation of the activities relating to economic development of the country.
- CBSL, in addition to being responsible for the supervision of banks, non-banks and the implementation of the provisions of the Exchange Control Act and the management of the public debt, is responsible for ensuring the financial system stability of Sri Lanka. It therefore has to take necessary measures to ensure that money laundering activities do not have an adverse impact on financial system stability.

**DNFBPs and other matters**

55. The following agencies have a role to play in the supervision of Sri Lanka's DFNBP sector:

- The Bar Association of Sri Lanka is the professional body which coordinates all activities relating to the professional conduct of lawyers in Sri Lanka.
- The Institute of Chartered Accountants of Sri Lanka is the professional body which coordinates all activities relating to the professional conduct of chartered accountants of Sri Lanka.
- The Sri Lanka Bankers' Association (Guarantee) Ltd. of Sri Lanka, a company formed by its member banks, is established to ensure the protection of the banking system of Sri Lanka. Its membership is restricted to licensed commercial banks of Sri Lanka.
- the Finance Houses Association of Sri Lanka is an association formed to safeguard the interest of the finance companies authorised to carry out activities in Sri Lanka.
- the Leasing Association of Sri Lanka is an association formed to safeguard the interest of the leasing companies authorised to carry out activities in Sri Lanka
- The Association of Primary Dealers' is formed to make representations on behalf of the primary dealers who are authorised to deal with government securities.
- The Licensed Stock Brokers are authorised to participate in the Stock Market which is regulated by the Colombo Stock Exchange which is supervised by the Securities and Exchange Commission of Sri Lanka.
- Sri Lanka Gems and Jewellery Association functions as a trade association only. It has issued a code of ethics for its members but does not issue any circulars or guidelines for its members.

### *c. Approach concerning risk*

56. Sri Lanka has not undertaken a comprehensive risk assessment of money laundering or the financing of terrorism.

### *d. Progress since the last mutual evaluation or assessment*

57. Not applicable – this is the first mutual evaluation of Sri Lanka.

# 2 LEGAL SYSTEM AND RELATED INSTITUTIONAL MEASURES

## *Laws and Regulations*

### 2.1 CRIMINALISATION OF MONEY LAUNDERING (R.1 & 2)

#### 2.1.1 DESCRIPTION AND ANALYSIS

**Recommendation 1**

58. Sri Lanka acceded to the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) on 6 June 1991 and signed on 13 December 2000, but has not yet ratified, the United Nations Convention on Transnational Organized Crime (the Palermo Convention).

59. In January 2006, Sri Lanka's Parliament enacted the Prevention of Money Laundering Act No. 5 of 2006 (PMLA), the purpose of which is to criminalize money laundering in accordance with both the Vienna and Palermo Conventions. The PMLA came into force on 6 March 2006 (during the Evaluation Team's on-site visit to Sri Lanka) after certification by the Parliamentary Speaker.

60. The PMLA creates two separate but overlapping money laundering offences over which the High Court of Sri Lanka has exclusive jurisdiction:

- Section 3(1)(a): engaging directly or indirectly in any transaction in relation to any property which is derived or realized, directly or indirectly, from any unlawful activity or from the proceeds of any unlawful activity, and

- Section 3(1)(b): receiving, possessing, concealing, investing in, disposing of, or bringing into, and transferring out of, Sri Lanka any property which is derived or realized, directly or indirectly, from any unlawful activity or from the proceeds of such activity.

61. These offences are "non-bailable" and "cognizable offences" as defined in the Code of Criminal Procedure which empowers a peace officer to arrest a suspect without a warrant.

62. "Property," as used in the terms of the offence, is defined at section 35 of the PMLA in a comprehensive manner to include any asset of any kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, whether in Sri Lanka or elsewhere. The definition also explicitly provides further that "property" includes currency, legal documents or instruments in any form (including digital or electronic form) evidencing title to or interest in assets. For clarity, the definition extends to include instruments issued by banks, shares, securities and other legal instruments. The definition does not place any restrictions on the value of property for the purpose of the offence.

63. Section 4 of the PMLA creates a rebuttable presumption that any property acquired by a person has been derived directly or indirectly from any unlawful activity, or are the proceeds of such activity, if the property cannot be or could not have been part of

the known income or receipts of an accused. Officials from the Attorney-General's Office confirmed to the Evaluation Team that this is more than an evidential burden but establishes a legal burden on the accused and indicated that the standard of proof is on the balance of probabilities. Section 13(5) of the Constitution of Sri Lanka permits burdens such as this to be placed on accused persons, notwithstanding the presumption of innocence in criminal proceedings.

64. Section 3(3) of the PMLA contains an avoidance of doubt clause which provides that a conviction for the commission by the accused of the predicate offence shall not be essential for the proof of the offence under the PMLA. The term "predicate offence" is not defined in the PMLA, but Ministry of Justice officials advised the Evaluation Team that it is intended to mean the same as "unlawful activity" which is defined at section 35 of the PMLA.

65. The term "unlawful activity" is defined to include a range of serious offences as follows:

a) offences under the Poisons, Opium and Dangerous Drugs Ordinance (Chapter 218);
b) any law or regulation for the time being in force relating to the prevention and suppression of terrorism;
c) offences under the Bribery Act (Chapter 26);
d) offences under the Firearms Ordinance (Chapter 182), the Explosives Ordinance (Chapter 183) or the Offensive Weapons Act, No. 18 of 1966;
e) offences under the Exchange Control Act (Chapter 423);
f) an offence under Section 83(c) of the Banking Act No. 30 of 1988 (pyramid schemes);
g) any law for the time being in force relating to transnational organized crime;
h) any law for the time being in force relating to cyber crime;
i) any law for the time being in force relating to offences against children;
j) any law for the time being in force relating to offences connected with the trafficking of persons;
k) an offence under any other law for the time being in force which is punishable by death or with imprisonment for a term of seven years or more.

66. Category (b) offences are contained in three separate enactments which are discussed in this report under Special Recommendation II. At the time of the on-site visit, category (g) offences had not been created, although Ministry of Justice officials advised that a Bill in Parliament to criminalize a number of related acts was proceeding (the Organized Crime Bill). Cyber crime offences at category (h) also have not as yet been created but are the subject of a Cyber Crimes Bill. Those offences listed in category (j) were passed into law just prior to the on-site visit in February 2006.

67. Category (k) provides a penalty threshold of seven years imprisonment to include serious offences not mentioned in the list. Hence, the PMLA contains a mixture of listed offences and a set threshold.

68. With respect to the interface between the seven year threshold and the list of designated categories of offences defined in the FATF Recommendations, the following offences are not included as "unlawful activity" for the purposes of money laundering as they do not attract a period of seven years or more imprisonment:

- environmental crimes (under the National Environment Authority Act No. 43 of 1980 and Flora & Fauna Ordinance Chapter 469 of Ceylon Legislative Enactments - CLE);

- smuggling (under the Customs Ordinance Chapter 235 of the CLE);
- Piracy (under the Intellectual Property Act No. 52 of 1979);
- insider trading and market manipulation (under the Securities Council Act No. 36 of 1987 which was subsequently as amended by Securities Council Act No. 26 of 1991 to read as Securities and Exchange Commission Act ).

69. Moreover, and although not listed within the FATF definition of "designated categories of offences," it should be noted that tax evasion is not an "unlawful activity" as it attracts a penalty of only 6 months imprisonment.

70. The avoidance of doubt clause at section 3(3) of the PMLA provides that an accused need not be convicted of a predicate offence to be convicted of a money laundering offence. Officials from the Ministry of Justice have however indicated that there is an ambiguity in the wording of the clause. The ambiguity suggests that it is necessary to convict a predicate offender before convicting a third part launderer unconnected with the predicate offence. Officials agree that this clause needs to be amended to clarify that this is not the case. In addition, the definition of "unlawful activity" at section 35 only lists Sri Lankan offences. Hence, where a foreign predicate offence generates proceeds of crime, a conviction for that foreign predicate offence would be required to convict someone in Sri Lanka for laundering those proceeds in Sri Lanka - even where the money launderer and the foreign predicate offender are the same person.

71. The new PMLA provides for ancillary offences to money laundering by providing that anyone who attempts, conspires, aids or abets the commission of a money laundering offence shall be guilty of an offence and subject to the same punishment as an offence for money laundering. Officials from the Attorney-General's office indicated to the Evaluation Team that under Sri Lankan law, "instigating" under the definition of "abetment" in section 100 of the Penal Code includes counseling for the purpose of the FATF standards (section 38(2) of the Penal Code extends section 100 to the PMLA). However, neither the PMLA nor the definition of "abetment" in the Penal Code includes "facilitate" as required by Article 6 of the Palermo Convention.

72. Sri Lankan criminal law does not provide that non-criminal conduct in another jurisdiction which would amount to an offence if it occurred in Sri Lanka is an offence for the purposes of the PMLA, Penal Code or other criminal law. This general position is reflected to some extent in the definition of "unlawful activity" as noted above, which is defined to refer only to offences under Sri Lankan law. It is worth noting, on the other hand, that under section 101A of the Penal Code a person in Sri Lanka who abets someone in another jurisdiction to commit an act there which is not an offence but does amount to an offence in Sri Lanka is guilty of abetting that act.

**Recommendation 2**

73. The money laundering offences in the PMLA apply to natural persons who know or have reason to believe that the property is the proceeds of unlawful activity. Either mental element ("know" or has "reason to believe") may be inferred from objective factual circumstances under the general principles of Sri Lankan criminal law.

74. The Act at section 18 also extends criminal liability to:

- a body corporate including its directors and officers;
- a firm and every partner of that firm; and
- an unincorporated body, other than a firm, as well as every member of that body, including its officers responsible for its management.

75. Moreover, neither the PMLA, the Penal Code nor the Code of Criminal Procedure precludes additional criminal, civil or administrative remedial action against legal persons following prosecution under the PMLA save and except that such additional proceedings must not breach the fundamental rule against double jeopardy in criminal proceedings.

76. The PMLA makes no distinction in imposing punitive consequences on natural or legal persons. The penalties for money laundering are:

- a fine not less than the value of the property in respect of which the offence is committed and not more than three times the value; or
- rigorous imprisonment for a period of not less than five years and not exceeding 20 years; or
- both a fine and imprisonment.

77. "Rigorous imprisonment" is defined under the Penal Code as imprisonment involving hard labour.

78. This punishment range provides wide scope for judicial discretion. The High Court may impose a sentence of simply a fine equivalent to the amount of the funds laundered and for this reason the sanctions framework cannot be said to be effective and dissuasive, as a fine of that nature would not necessarily have a deterrent effect, particularly where the offender is not the predicate offender facing penalties for other offences.

79. Given the fact that the PMLA only came into force during the on-site visit, there are no statistics available on investigations, prosecutions and convictions. The evaluation Team was advised by the police that there were no planned investigations for these offences at the time of the visit.

### 2.1.2 RECOMMENDATIONS AND COMMENTS

80. The enactment of the PMLA represents an important development for Sri Lanka in implementing the FATF Recommendations. There are, however, a number of important implementation initiatives which Sri Lanka must take as soon as possible now that the PMLA is in force, including:

- establishing courses or awareness training for judges, prosecutors and police to raise the level of awareness of this new enactment and to understand and detect the various forms of money laundering; and
- ensuring the effective use of this new enactment by committing police resources to investigating and detecting this offence.

81. The Attorney-General, the Secretary of Justice and the police acknowledged that these initiatives must be implemented as soon as possible in order to make these laws effective. Indeed, the view was expressed by officials that awareness training should be extended to Parliamentarians as well. However, at the time of the on-site visit no courses or training had been scheduled nor indeed designed. In addition, while the police acknowledged that they intend to conduct investigations into these new offences as soon as incidents of money laundering are brought to their attention, they had not as yet decided whether to establish an anti-money laundering investigative unit. Sri Lanka is encouraged to develop these and other relevant initiatives at the earliest opportunity.

82. Apart from these points there are a number of additional steps and enhancements to the PMLA which should be taken to more effectively implement FATF Recommendations 1 and 2, in particular:

- Sri Lanka should immediately deposit its instrument of ratification to the Palermo Convention;
- the seven year offence threshold at section 35 should either be lowered to include the offences not currently included in the FATF designated category of offences, or alternatively, those FATF designated offences should be explicitly included as listed offences at section 35;
- the avoidance of doubt clause at section 3(3) should be amended to provide that a conviction by a predicate offender is also not required for prosecution of a money launderer not connected with the predicate offence;
- the definition of "unlawful activity" at section 35 should be extended to include conduct that occurs in another jurisdiction which either constitutes an offence in that jurisdiction or, if it had occurred in Sri Lanka would be unlawful activity in Sri Lanka;
- the ancillary offences at section 3(2) should be extended to include "facilitation" in accordance with the Palermo Convention; and
- Sri Lanka should consider changing the penalty structure for money laundering offences to provide that it is more dissuasive.

### 2.1.2 COMPLIANCE WITH RECOMMENDATIONS 1 & 2

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.1** | **Partially Compliant** | • Not all FATF designated offences are included as predicate offences to money laundering<br>• Third party predicate offenders may require prosecution prior to money laundering prosecutions<br>• Only domestic offences are considered predicate offences – not foreign offences<br>• Ancillary offences should include all requirements of the Palermo Convention |
| **R.2** | **Partially Compliant** | • **Penalty framework is not dissuasive**<br>• **The offences are not yet fully implemented** |
| **R.32** | **Partially Compliant** | • **There are no statistics of offences as yet given the PMLA has just come into force** |

## 2.2 CRIMINALISATION OF TERRORIST FINANCING (SR.II)

### 2.2.1 DESCRIPTION AND ANALYSIS

Summary

83. Sri Lanka signed the International Convention for the Suppression of Terrorist Financing on 10 January 2000 (the day it opened for signature) and ratified it on 8 September 2000.

84. In 2001, shortly after the September 11 attacks in the United States, Sri Lanka issued UN Regulation No. 1 of 2001 and in August 2005 enacted the Convention on the

Suppression of Terrorist Financing Act No. 25 of 2005. Both of these instruments create terrorist financing offences: the first explicitly in response to UN Security Council Resolution 1373 and the second in order to implement the UN Terrorist Financing Convention.

85. In general, the offences in both instruments reflect the terms of both UN instruments, although some requirements are either not covered or inadequately covered in these enactments. In addition, there are some significant interface issues between the Act and the Regulation.

Offences in UN Regulation No. 1 of 2001

86. This Regulation was issued by the Minister of Foreign Affairs under the delegated authority of the United Nations Act No. 45 of 1968, section 2(1). The Regulation creates two offences:

- Section 6(a): provides that no citizen or resident of Sri Lanka (as well as Sri Lankan citizens living abroad) shall do any act which assists or promotes or is intended to assist or promote any act which is directly or indirectly connected with the collection of funds for any terrorist organization or which are intended to be used to carry out a terrorist act; and

- Section 6(c): provides that no citizen, person, or body of persons shall within Sri Lanka make available directly or indirectly for the benefit of any organization or person, who commits or attempts to commit or participates in or facilitates the commission of any terrorist act, any funds, financial assets or economic resources.

87. A “terrorist organization” for the purposes of section 6(a) is defined as one which either commits terrorist acts or is connected with the collection of funds for terrorists connected with those acts (section 10). “Terrorist act” is defined, but the term “organization” is not. Officials from the Ministry of Foreign Affairs indicated that the latter term is meant to cover two or more persons and not just one person. Funding one person is however an offence under section 6(c).

88. The terms “funds,” “financial assets” and “economic resources,” while taken directly from the wording of UN Security Council Resolution 1373 (operative paragraph 1(d)), are not defined in this Regulation and it is unclear whether they would cover what is intended in the definition of “funds” at Article 1 of the Terrorist Financing Convention.

89. The Regulation does not make it clear, as required by the Convention, that it shall not be necessary that the funds were actually used to carry out a terrorist act. Moreover, there is no clear statement that it would be an offence to attempt to commit the offences at section 6(a) and 6(c) as required by the Terrorist Financing Convention (the reference to “attempt” in section 6(c) is to the terrorist act for which the funding is provided and not to the operative financing offence).

90. This Regulation also does not provide that it is an offence to engage in any of the types of conduct stipulated in Article 2(5) of the Terrorist Financing Convention.

Offences in Convention on the Suppression of Terrorist Financing Act No. 25 of 2005

91. This Act, which came into force in August 2005, does not repeal, amend or affect the UN Regulation discussed above.

92. The Act creates two offences as follows:

- Section 3(1)(a): unlawfully and willfully providing or collecting funds, directly or indirectly, intending, knowing or having reason to believe that they will be used to commit an act which constitutes an offence under any of the terrorist conventions listed in a Schedule to the Act[3]; and

- Section 3(1)(b): unlawfully and willfully providing or collecting funds, directly or indirectly, intending, knowing or having reason to believe that they will be used to commit any other act intended to cause death or serious bodily injury to civilians or others not taking an active part in hostilities in a situation of armed conflict in order to intimidate or compel a government or international organization to do or abstain from doing any act.

93. It is also an offence to attempt, aid or abet the commission of these offences, or act with a common purpose with one or more persons to contribute to these offences.

94. The offences do not apply to funding terrorist organizations or individual terrorists per se. They are targeted specifically at financing terrorist acts.

95. Article 1(1) of the Terrorist Financing Convention contains a comprehensive definition of "funds" but this definition has not been incorporated within the Act – nor for that matter has any definition of "funds" been inserted in the Act. The Interpretation Ordinance also does not contain a general definition of this term which might have been applicable to this Act. It is therefore uncertain whether the term "funds" would be given a restrictive or comprehensive definition (to reflect the Convention) by the Courts.

96. The Act does nevertheless provide that it is not necessary to show that any funds collected in contravention of the offence provisions were actually used in the commission of an offence.

97. The further offences listed at Article 2(5) of the Convention are covered by section 3(3) of the Act – acting as accomplice, organizing, contributing. The term "abet" in section 100 and 101 of the Penal Code is directly incorporated in the Act by section 3(2). "Abet" includes "instigate" as noted in the discussion on the PMLA.

Assessment of UN Regulation and Convention Act vis-a-vis other FATF criteria

98. The PMLA includes as unlawful activity (predicate offences), any law or regulation in force relating to the prevention and suppression of terrorism. Both UN Regulation No. 1 of 2001 and the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 are included within the scope of this provision.

99. The Regulation and the Act have varying provisions relating to the extra-territorial jurisdiction of the offences, some of which are problematic. Under UN

[3] The nine listed Conventions at Schedule 1 to the Act are: Convention for the Suppression of Unlawful Seizure of Aircraft; Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation; Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents; International Convention Against the Taking of Hostages; Convention on the Physical Protection of Nuclear Material Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, Supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation; Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation; Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on the Continental Shelf; International Convention for the Suppression of Terrorist Bombings.

Regulation No. 1, section 6(a) applies to Sri Lankan citizens and residents within Sri Lanka, but only to Sri Lankan citizens outside Sri Lanka (not to its residents). Accordingly:

- a Sri Lankan resident abroad who does any act which directly or indirectly assists with the collection of funds for a terrorist organization (as described in section 6(a)) has not committed an offence under that section; and
- a visitor to Sri Lanka whose sole purpose in entering the country is to engage in the activity prohibited in section 6(a) also does not attract any criminal liability - in other words it allows visitors to do what is prohibited for its citizens and residents. ( To give effect to the intention of the legislature, the word "Resident " will be given an extended meaning to cover "Visitors"

100. Under the same UN Regulation, section 6(c) applies only to citizens, other persons and bodies of persons "within the territory of Sri Lanka". Hence, Sri Lankan citizens and others outside Sri Lanka may make funds available to terrorists within Sri Lanka who participate in terrorist acts without attracting any criminal liability under the Regulation. Sri Lankan citizens living outside Sri Lanka also become liable under section 6(c).

101. On the other hand, under the Convention on the Suppression of Terrorist Financing Act, the High Court has extensive extra-territorial jurisdiction over citizens, residents and others, including those outside Sri Lanka and including non-citizens, residents and others with no connection to Sri Lanka, who commit the prohibited act of financing terrorist acts (section 6).

102. Not only does jurisdiction differ between the terrorist financing offences, the mental elements with respect to the terrorist financing offences under the Act and the Regulation also differ - and markedly. Under the Regulation there is no mental element outlined in the offence provisions. The wording in both regulatory offences does not conform to the requirements of the Terrorist Financing Convention and it appears on the face of the wording that both are absolute liability offences. Officials from the Ministry of Foreign Affairs as well as the Office of Legal Draftsman indicated, however, that the offences are not intended to be ones of absolute liability given that the penalty for these offences is a minimum of five years to maximum of 10 years imprisonment. Officials nevertheless acknowledged that there was ambiguity in these offences and that no cases have yet considered this point.

103. Under the Act, on the other hand, the wording of these offences reflects exactly the wording of Article 2(1)(a) and (b) of the Terrorist Financing Convention. The required mental element in each of the offences is brought directly into Sri Lankan domestic law and therefore complies with the dual *mens rea* requirements of the Convention – indeed the offences extend the requirement to "have reason to believe" which is not required by the Convention. This lower mental element is not, however, inconsistent with the requirements of the Convention. Under general Sri Lankan criminal law, these mental elements may be inferred from objective facts.

104. There is an additional problem with the construction of the offence at section 3(1)(a) of the Convention on the Suppression of Terrorist Financing Act. Under the Act it is an offence to provide or collect funds to commit an act contrary to any of the nine anti-Terrorist Conventions Scheduled to the Act. But the offences in those listed Conventions are not as yet incorporated into Sri Lankan law. And because there is no general definition of "terrorist act" under this enactment or a general terrorist offence in Sri Lankan law which gathers the discrete Convention elements of the offences together, there is a high degree of uncertainty with respect to this offence. The weaknesses, not to mention

difficulties, with this approach are uncertainty and ambiguity of the law as well as a general lack of accessibility to the law in order to know that a proposed course of action may be unlawful.

105. With respect to liability for legal persons under both the Regulation and under the Act, neither the Regulation nor the Act define "person." That term is, however, defined in both the Code of Criminal Procedure and the Interpretation Ordinance (which are roughly the same). It is not clear whether the former applies to the Regulation (given that it was issued under the United Nations Act and not a penal enactment) but the Interpretation Ordinance does apply and that instrument defines "person" as including "any body or persons corporate or unincorporate." The FATF definition of "legal persons," on the other hand, defines the term more widely as including "bodies corporate, foundations, *anstalt*, partnerships, or associations, or any similar bodies that can establish a permanent customer relationship with a financial institution or otherwise own property." It is unclear whether the Interpretation Ordinance definition extends as far as that of the FATF.

106. It is also worth noting that the penalties under the Regulation and under the Act are very different. Under the former, an accused is subject to a minimum of five years and maximum of 10 years imprisonment, while under the Act the minimum penalty is 15 years and maximum 20 years imprisonment. While these penalties in themselves are effective and dissuasive there is a 'disconnect' between them because one set is within a Regulation and the other in an Act – on the face of the law, financing a terrorist organization is less serious than financing a terrorist act.

107. Officials from the Attorney-General's Office, the Ministry of Justice, the Police and the Ministry of Foreign Affairs all indicated that there have been no investigations, prosecutions or convictions under UN Regulation No. 1 of 2001 (despite being in force for five years) nor have any investigations been commenced under the Convention for the Suppression of Terrorist Financing Act (in force for seven months as of the on-site visit date).

108. The Sri Lankan authorities emphasised that the UN Regulation was meant as an interim measure taken under the United Nations Act to provide an immediate legal framework to give effect to a binding Resolution under Chapter 7 of the UN Charter, pending the introduction of legislation to give effect to the provisions of the Terrorist Financing Convention, as well as AML legislation. However, the Evaluation Team notes that whether intended as an interim measure or otherwise, the UN Regulation remains in effect and that there remain interface issues between the new Act and the Regulation which need to be addressed.

2.2.2 RECOMMENDATIONS AND COMMENTS

109. There are significant structural disparities between the terrorist financing offences in the UN Regulation and in the new Act. It is recommended that:

- The offences in the UN Regulation should be moved into the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 and the penalties should be harmonized, preferably with the same penalty structure in the Act;
- The Act should incorporate the definition of "funds" as contained in the Terrorist Financing Convention;
- Once the Regulation offences are moved into the Act, the Act should further provide that those offences:

    a. apply to funding both a terrorist organization and an individual terrorist

b. contain the requisite mental elements consistent with the Terrorist Financing Convention, and
c. have the same extra-territorial effect as the current terrorist financing offences in the Act.

- The Act should clarify what offences in the nine terrorist Conventions listed in Schedule 1 to the Act are applicable to terrorist financing – this could be achieved by inserting a comprehensive definition of "terrorist act" in that statute, and
- The Act should include a comprehensive definition of "person" to include, at least, the entities contemplated in the FATF definition of "legal person" or, alternatively, the Act should clarify that the offence applies to the same entities to which the PMLA applies.

#### 2.2.3 COMPLIANCE WITH SPECIAL RECOMMENDATION II

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **SR.II** | **Partially Compliant** | • **The terrorist financing offence at section 6(a) of the UN Regulation does not include funding a single terrorist**<br>• **The definition of "funds" in the Act and in the UN Regulation do not extend to what is required by the Terrorist Financing Convention**<br>• **Extra-territorial jurisdiction of offences under the UN Regulation is restricted to Sri Lankan citizens only**<br>• **Domestic jurisdiction over the UN Regulation offences is severely restricted to Sri Lankan citizens and residents only** |
| **R.32** | **N/A** | • **There have been no investigations, prosecutions or convictions under either the UN Regulation or the Act.** |

## 2.3 CONFISCATION, FREEZING AND SEIZING OF PROCEEDS OF CRIME (R.3)

### 2.3.1 DESCRIPTION AND ANALYSIS

Overview

110. Sri Lanka does not have a Proceeds of Crime Act or other similar general mechanism to confiscate the proceeds of crime. However, there are targeted mechanisms to freeze and confiscate assets in relation to money laundering, terrorism and terrorist financing under the following enactments:

- Prevention of Money Laundering Act No. 5 of 2006;
- Prevention of Terrorism Act No. 48 of 1979[4];
- Convention for the Suppression of Terrorist Financing Act No. 25 of 2005, and
- UN Regulation No. 1 of 2001.

Forfeiture Mechanisms

[4] This Act is emergency legislation targeted at preventing domestic terrorism. During the on-site visit the evaluation team was advised that this legislation had been "suspended" as a result of the peace talks taking place at that time between the Government and the LTTE.

111. The PMLA permits the High Court (after conviction of an offender) to order that any moveable or unmovable property, derived or realized, directly or indirectly, from any unlawful activity (ie predicate offences to money laundering as defined in the Act) be forfeited to the State. The term "property" is widely defined, as noted earlier in this report. The operative section covers proceeds from the commission of money laundering offences, but it does not include instruments used, or intended to be used, in the commission of such offences. Whether or not it includes income or profits generated from the proceeds of crime is unclear. The provision does say it includes property derived "indirectly" from unlawful activity but this word alone is likely not enough to cover profits or income generated from such proceeds. The forfeiture provisions of the PMLA do not apply to property of corresponding value.

112. The Prevention of Terrorism Act contains 10 distinct offences at sections 2 and 3. On conviction for any of these offences, section 4 permits the court to order the forfeiture of "all property movable and immovable" of the offender. This section is wide enough to cover anything whether or not they are the proceeds, instruments or profits of crime.

113. Under the Convention on the Suppression of Terrorist Financing Act, the High Court may on conviction grant a forfeiture order with respect to funds collected by an accused person in contravention of the offence provisions at section 3. However, as noted earlier in this report, the term "funds" is not defined. The context suggests that neither instruments used in, or intended to be used in, the commission of offences under this Act, nor profits or income generated, may be forfeited under this provision.

114. On conviction for a terrorist financing offence under UN Regulation No. 1 of 2001, "any funds, or other financial assets or resources" of the offender shall be forfeited to the State. None of the quoted terms are defined, but they do appear to encompass assets of an offender not necessarily related to the commission of terrorist financing offences. However, given that no case has yet considered this Regulation, it is not clear whether these terms would include instruments of crime – the terms appear to be related solely to financial assets in the form of funds or economic resources.

Freezing Mechanisms

115. On a pre-conviction basis under the PMLA, a Superintendent of Police may issue an order on an *ex parte* basis to freeze any account, property or investment if he has reasonable grounds to believe that a person is involved in "any activity relating to money laundering" (ie "unlawful activity" as defined in that Act) and it is necessary to prevent further offences under the Act. The order is valid for seven days and may be confirmed and extended by a High Court order. This appears to be an effective provision for freezing.

116. The Prevention of Terrorism Act contains no interim (ie pre-trial) mechanism to freeze or seize assets relating to offences under the Act.

117. Under the Convention on the Suppression of Terrorist Financing Act there are two pre-conviction interim freezing and seizure mechanisms available:

- the first provides that the Attorney-General may apply to the Court after the accused is indicted. This procedure is not without notice to the accused, however, as the order may only be made following that person's indictment in the High Court. It is possible therefore for offenders to secrete or dissipate assets prior to indictment;

- the second provides that if during a trial for an offence under the Act evidence is adduced as to the existence of a bank account standing to the credit of the accused, the court may issue an order to the bank manager to freeze those funds. Again, because of the circumstances of the making of the order, there would be notice to the accused of the freezing order. Moreover, the applicable section (section 5(3)) only applies to "bank accounts" and not other financial assets.

118. Pursuant to UN Regulation No. 1 2001, any "funds or financial assets or resources of persons" who do any act which assists or promotes any act directly or indirectly connected with a terrorist organization or terrorist act, or if that person participates in a terrorist act, are immediately frozen. It is an offence to contravene this provision punishable by a minimum of five and maximum of 10 years imprisonment. The Regulation does not, however, stipulate a mechanism to effect the freezing – it simply provides that on doing of any prohibited acts the person's assets are frozen. By whom, and how, the freezing occurs is not provided for in the Regulation. Because of this, the effectiveness of this provision is doubtful. Officials from the Attorney-General's Office, the Ministry of Foreign Affairs (which administers the Regulation), the CBSL and the Ministry of Justice all indicated that no funds have yet been frozen under this Regulation.

119. The PMLA contains broad powers to track and monitor the proceeds of crime which are frozen under a police freezing order including the power to apply to the court for document disclosure orders. The Prevention of Terrorism Act also gives police very broad powers of search and seizure without a warrant to assist in the investigation of offences under that Act although these powers are not specifically related to the tracing and tracking of the proceeds of crime. On the other hand, there are no specific powers provided to track proceeds in either UN Regulation No. 1 or the Convention on the Suppression of Terrorist Financing Act.

120. Although not specifically related to the power to identify or trace property, the Financial Transactions Reporting Act No 6 of 2006 empowers the FIU to collect, or require supervisory authorities of financial institutions to collect, information relevant to an offence of money laundering, terrorist financing or terrorist activity whether or not publicly available.

121. While the PMLA at section 13 provides third parties with the right to apply for relief for any interest they may have in assets frozen or seized, none of the other three enactments discussed above extends such rights.

122. There is no mechanism in any enactment (such as a Fraudulent Conveyances Act or otherwise) by which fraudulent transactions, void or voidable transactions may be unwound or nullified so as not to prejudice the ability to confiscate assets which are subject to the provisions discussed.

123. Sri Lanka does not have a mechanism to confiscate property from criminal organizations whose principal function is to perform or assist in performing illegal activities. Nor does Sri Lanka have a civil (ie non-conviction based) forfeiture system.

124. There have been no freezing, seizing or confiscations of assets pursuant to the PMLA or Convention for the Suppression of Terrorist Financing Act - as both Acts are new. Despite being issued over five years ago, there have also been no such actions taken under UN Regulation No. 1 of 2001. Importantly, there seems to be a general lack of knowledge among key agencies, such as the Police and Customs, in regard to this Regulation. Sri Lankan officials were not able to provide any statistics on confiscation orders, if any, made pursuant to the Prevention of Terrorism Act.

### 2.3.2 RECOMMENDATIONS AND COMMENTS

125. The current proceeds of crime regime in Sri Lanka is too restrictive in terms of the offences it covers. It contains varying mechanisms in a number of statutory instruments which are inconsistent with one another.

126. The following recommendations are made to improve the existing arrangements:

- Sri Lanka should consider the option of establishing a freezing, seizing and confiscation/forfeiture regime within a single statute (such as a Proceeds of Crime Act) which would consolidate and improve the existing mechanisms for dealing with, and managing, the proceeds of money laundering, terrorist financing and other crimes. One of the aims of single system would be to establish a fundamental consistency in the mechanisms used to confiscate proceeds;
- the confiscation regime should apply to the proceeds of, and instruments used in or intended to be used in the commission of, any money laundering, terrorist financing or other predicate offences;
- the regime should also apply to profits, income or other benefits generated from the proceeds of crime as well as property of corresponding value;
- there should be a clear, effective and workable interim freezing mechanism to freeze the proceeds of crime. The system contained in the PMLA whereby the Police may issue freezing orders subject to confirmation by the High Court is an example of such an effective system;
- authorities, whether Police or otherwise, should have effective powers to identify, and trace property which may be the subject of confiscation;
- the interim freezing mechanism should be on an *ex parte*, without notice basis, in order to avoid the potential that assets sought to be confiscated will be secreted or dissipated within or outside Sri Lanka;
- the rights of third parties in assets subject to confiscation or freezing should be acknowledged by a mechanism which permits them to apply for relief;
- the regime should contain a mechanism whereby fraudulent or void(able) transactions designed to hide or dissipate assets to defeat freezing and confiscation action may be voided or ignored by authorities for this purpose; and
- Sri Lanka should consider implementing a system whereby assets of criminal organizations may be confiscated and in conjunction with this implement a wider civil (non-conviction based) forfeiture system.

### 2.3.3 COMPLIANCE WITH RECOMMENDATION 3

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.3** | **Partially Compliant** | • **The PMLA, UN Regulation No. 1 and Convention for the Suppression of Terrorist Financing Act do not apply to income, profits, instrumentalities of crime or property of corresponding value**<br>• **Freezing mechanism under Convention for the Suppression of Terrorist Financing Act is not without notice; the mechanism under the UN Regulation No. 1 is ineffective**<br>• **Terrorist Financing Act and Regulation contain no tracking procedures**<br>• **No mechanism to void fraudulent transactions** |

| R.32 | Non-Compliant | • **Effective implementation of the current system is lacking key agencies, including Police, are unaware of UN Regulation No. 1 of 2001**<br>• **No statistics are available on freezing and confiscation under UN Regulation and Prevention of Terrorism Act** |
|---|---|---|

## 2.4 FREEZING OF FUNDS USED FOR TERRORIST FINANCING (SR.III)

### 2.4.1 DESCRIPTION AND ANALYSIS

Background – UN Regulation No. 1 of 2001

127. Shortly after the September 11 attacks, the Minister of Foreign Affairs issued UN Regulation No. 1 of 2001 pursuant to United Nations Act No. 45 of 1968 (discussed at length in previous sections). While this instrument refers to UN Security Council Resolution 1373, its primary reference is to UN Security Council Resolution 1189 (of 1998) – which was not a Chapter VII Resolution – and states that "every State has the duty to refrain from organising…a terrorist act in another State…and all States take necessary and effective measures to give effect to such decision." (ie Resolution 1189).

128. In that vein, the Regulation appears to be concerned with implementing measures against "States" and not against individuals. It is arguably not about implementing Resolution 1373. In addition, there is no mention of UN Security Council Resolution 1267, however, as discussed below, this Regulation has been used to list 1267 terrorist entities.

129. The Regulation provides that there shall be a "central authority" appointed by the Minister of Foreign Affairs and provides a mechanism for that Minister (on information received from the Minister of Defence) to determine organizations or persons against whom this Regulation shall be enforced. The CBSL has been appointed as the central authority.

Implementation of UNSCR 1267

130. Pursuant to this Regulation, 198 terrorist entities and organizations have been listed (as of the date of the Evaluation Team's on-site visit). Of these, 197 are Al Qaeda/Taliban entities listed by the UN 1267 committee. It is unclear that this Regulation is authority to establish a 1267 list domestically for the reasons stated above but, nonetheless, it has been used for this purpose.

131. This Sri Lankan list was established in 2001 and updated in 2002, but has not since been updated to reflect additional 1267 Committee entities: as at 22 February 2006, there were 473 Al Qaeda/Taliban entities listed by the 1267 Committee, leaving a gap of 276 entities requiring listing by Sri Lanka.

132. On 12 November 2001, the Controller of Exchange and the Director of Bank Supervision from the CBSL jointly issued direction No. 06/04/13/2001 to all commercial and specialized banks drawing their attention to UN Regulation No. 1. The directive states that Resolution 1267 requires the freezing of funds, other financial assets and resources of designated persons, their associates and any persons connected with them. The directive also:

- instructs the institutions not to open new accounts to designated persons or their associates on the list;
- directs that accounts already opened are to be frozen immediately and that the CBSL should be informed of this within 10 days; and
- requires those banks not to make any payment in Sri Lanka or abroad to the credit of any of the listed persons or to anyone connected with those organisations.

133. Similar directives have been issued to finance companies, money changers, travel agents and persons authorised to engage in foreign exchange transactions.

134. This directive was followed up with four further directives as follows:

- Ref No. 06/04/16/2001, 28 December 2001: directs banks to a US Treasury interim guidance note on correspondent banking. It instructs all Commercial Banks not to enter into correspondent accounts with shell banks;

- Ref No. 06/04/01/2002, 25 January 2002: informs all commercial banks and specialized banks that the UN Security Council had de-listed "Da Afghanistan Bank" and that this Bank has been removed from the list under the Regulation (although the list the evaluation team was provided still shows "Da Afghanistan Bank" as a domestically listed entity (number 187 on the list));

- Ref No. 06/04/04/2002, 7 February 2002: this directive provides banks with an updated list of 1267 entities and makes reference to the LTTE as a listed entity; and

- Ref No. 06/04/07/2003, 3 March 2003: asks banks to send details of any entity which has tried to open an account or transact business and reminds them of their obligations to report suspicious activities.

Implementation of UNSCR 1373

135. Sri Lanka has designated one entity pursuant to UN Security Council 1373: the Liberation Tigers of Tamil Elam (LTTE). The CBSL directions noted above apply to this entity in the same way they do with respect to the remaining listed entities.

136. It is important to note that no particular members of the LTTE are listed under this Regulation – only the name of the organisation itself. When questioned why this is so, officials from the CBSL, Police and the Ministry of Foreign Affairs indicated that it was "not necessary" to list individual members. When questioned whether it was possible to freeze assets of LTTE members not listed, officials indicated that it was.

137. It is also important to note that there does not appear to be any general prohibition in Sri Lankan law against recruiting into or participating in a designated terrorist organization. Nether the Regulation itself nor the Prevention of Terrorism Act nor the Penal Code contains any such offences. There is limited utility therefore in simply listing the name of a terrorist group with no particular sanctions around it (as required by UN Resolution 1373) and, in particular, where there is a very high degree of improbability that accounts in financial institutions will be opened in the name of the listed group.

Effectiveness of the Freezing Mechanism

138. UN Regulation No. 1 does not contain any obligations on banks or other financial institutions with respect to entities listed under that instrument.

139. The sole freezing mechanism in this Regulation (as discussed in the last section of this report) relates to those who do acts which assist or promote terrorist organizations or terrorist acts. This does not provide that the assets of listed entities per se are to be frozen – only those assets of persons assisting terrorist organizations. "Terrorist organization" is not defined to mean those entities listed under the Regulation, but includes any organization (which must be one or more persons) who does acts connected with the collection of funds and which promotes or assists a terrorist act. It is therefore unclear on what legal basis this directive could, or is being, enforced against financial institutions.

140. With respect to the 1373 listing, in particular, the sole naming of the LTTE is in the Evaluation Team's view insufficient to effect freezing against members of the organization. When individual banks and finance companies were questioned on this point it was commented that it would be "highly unlikely" that an account would opened in the name of this organisation – none of them has seen such an account. Moreover, while the CBSL directives provide that institutions are to freeze accounts or not open accounts for the associates of the listed entities there is no mechanism or assistance to identify these associates other than through the listing process (which, to repeat, for the LTTE has not been used).

141. Additionally, given that the 1267 list of entities is not up to date for the domestic list, when financial institutions were questioned whether they check the actual 1267 list or other lists (such as that published by Office of Foreign Asset Control), no institutions indicated that they check such lists or others.

142. There is no mechanism in Sri Lankan law to give effect to freezing orders or actions of foreign jurisdictions under UN Security Council Resolutions 1267 or 1373. Although the Evaluation Team was pointed to Part VII and, in particular, sections 19(1)(a),(b) of the Mutual Assistance in Criminal Matters Act, No. 25 of 2002 as the applicable law, those provisions apply only to criminal proceedings (either when a person has been charged with an offence or if after criminal proceedings have been completed the court has made an order forfeiting property, or imposing a fine or restraining any persons from dealing with property). Those provisions do not operate as a mechanism to give effect to terrorist entity freezing orders of foreign jurisdictions.

143. Although the CBSL issues directives to financial institutions which it regulates, the legal basis of the directives to freeze listed entity's assets is not clear nor is the framework within which those directives are issued.

144. Neither the UN Regulation nor other Sri Lankan law has a publicly known mechanism to consider de-listing a person or entity named under the Regulation.

145. Sri Lankan officials were not able to point to effective or publicly known procedures for unfreezing assets of persons inadvertently affected on verification that the person or entity is not a designated person. The CBSL did indicate, however, that:

- any such person or entity could "appeal" to the CBSL which would consult with the Ministry of Foreign Affairs and Ministry of Defence to determine whether the person concerned is not the same as the listed entity by the UN. If they are not, the CBSL would take immediate steps to inform the bank concerned to release their funds; and
- if a person wished to challenge a decision of a financial institution not to unfreeze funds he could "file a case in court on the grounds of violation of fundamental rights."

146. These procedures are *ad hoc* and not provided for in UN Regulation No. 1 nor in any other provision relating to freezing terrorist assets. There is no information on how

these procedures would work nor does there appear to be any publicly available scheme to inform persons of these mechanisms. In terms of “filing a case in court,” it is not clear what kind of action this would be and under what statutory provision; and whether this procedure would permit unfreezing for basic expenses, payments of fees or other expenses, including those that are extraordinary.

147. In addition, there are no provisions to protect the rights of third parties whose rights have been affected by an institution’s freezing of funds pursuant to the CBSL’s direction.

148. The additional elements to SR III including implementation of the best practices have not been effected in Sri Lanka.

149. The last report of Sri Lanka (19 March 2004) to the 1267 Committee (S/AC.37/2004/(1455)/14) confirms as of that date that no freezing actions had been taken in regard to the CBSL directives. Officials during the on-site visit also confirmed that since that date no freezing has taken place.

### 2.4.2 RECOMMENDATIONS AND COMMENTS

150. The Evaluation Team was told by officials that the scheme for designation of terrorists and the freezing of their assets was put in place rather quickly following the attacks of September 11. It was acknowledged that it needs improvement. The system can be improved considerably by adopting the following recommendations:

- Sri Lanka needs to establish clear and effective procedures for the implementation of UN Security Council Resolutions 1267 and 1373 (and their successor Resolutions) – the current UN Regulation is not clear in this regard and is of dubious legal authority for this purpose;
- Sri Lanka needs to incorporate UN 1267 Committee listed entities as early as possible into domestic law in order to comply with their international obligation to freeze any assets of those entities without delay;
- the procedures should include an effective, *ex parte*, asset freezing mechanism for listed entities;
- the procedures should; also include a mechanism to give effect to foreign jurisdiction freezing orders;
- UN designated entities need to be communicated to banks and other financial institutions immediately pursuant to effective domestic procedures; and
- Sri Lanka should establish a clear, effective, and public mechanism for de-listing terrorist entities, both for those listed/de-listed by the 1267 Committee and for those whom Sri Lanka chooses to list or designate under Resolution 1373.

### 2.4.3 COMPLIANCE WITH SPECIAL RECOMMENDATION III

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **SR.III** | **Partially Compliant** | • **Sri Lanka does not have an effective mechanism to freeze terrorist funds or other assets pursuant to Resolutions 1267 and 1373**<br>• **Sri Lanka does not have an effective and publicly known procedure for considering de-listing and unfreezing requests in a timely manner** |

## 2.5 THE FINANCIAL INTELLIGENCE UNIT AND ITS FUNCTIONS (R.26, 30 & 32)

### 2.5.1 DESCRIPTION AND ANALYSIS

**Recommendation 26**

151. At the time of the on-site visit, the Parliament of Sri Lanka had just passed the Financial Transactions Reporting Act No 6 of 2006 (FTRA). The FTRA came into force on 6 March 2006 (during the Evaluation Team's on-site visit to Sri Lanka) after certification by the Parliamentary Speaker.

152. It should be noted that, while the FTRA sets out the powers and functions of the Financial Intelligence Unit (FIU), it does not actually establish it. Rather, section 33 of the FTRA (the definition section of the Act) defines the FIU to be:

> *"the government department, public corporation, institution, or authority designated by the Minister by Order published in the Gazette, which shall be charged with the administration of the provisions of this Act; the Minister shall in making the Order take into consideration the capacity of the Government department, public corporation, statutory body or authority to be designated in relation to its functions and manpower and its overall ability to act efficiently in the discharge of the functions under this Act".*

153. In short, under the FTRA the FIU is to be established by Order (regulation). It was explained to the Evaluation Team that this approach was taken because, at the time the FTR Bill was introduced into Parliament in late 2005, a final decision had not been made by the Government as to the location of the FIU.

154. The Evaluation Team was also advised that the Government had subsequently decided that the FIU would in fact be established as an independent, multi-disciplinary body within the CBSL comprising of a variety of personnel from regulatory, competent authorities and law enforcement agencies. On 23 March 2006, the President of Sri Lanka issued an Order pursuant to the FTRA designating the FIU of the CBSL as the FIU for the purposes of the FTRA, charging it with the implementation and administration of the provisions of the FTRA.

155. Prior to the on-site visit, the Sri Lankan authorities provided the Evaluation Team with an outline of the proposed structure of the Financial Intelligence Unit (FIU), which is at Attachment A to this report. As at the time of writing, the head of the FIU was yet to be appointed and the Sri Lankan authorities were still in the process of determining the precise functions, structure and operational procedures of the FIU. A steering committee for the FIU under the Ministry of Finance has been set up to co-ordinate all concerned parties and oversee the establishment of the FIU office and related issues.

156. The FTRA generally incorporates all the requirements of FATF Recommendation 26, with the primary issue now being effective implementation of the legislative provisions. The powers and functions of the FIU are clearly stated in the FTRA. Under section 15 of the FTRA, the FIU:

- shall receive reports and information by any agency of another country, law enforcement agency or a government institution or agency; and other information voluntarily provided to the FIU about suspicions of an act constituting "unlawful activity" (see paragraph 28 of this report for the definition of unlawful activity);
- shall collect or require the supervisory authority of a financial institution to collect any information that the FIU considers relevant to an act constituting unlawful activity, or an offence of money laundering or financing of terrorism or terrorist activity, including the material held in commercial and government databases;

- may request information from any government agency, law enforcement agency and supervisory agency for the purposes of the FTRA;
- may analyse and assess all reports and information;
- shall carry out examinations of all Institutions as set out in section 18 of the FTRA;
- shall after analysis and assessment, refer to the appropriate law enforcement agency or relevant supervisory authority any matter or information that the FIU has reasonable grounds to suspect would be relevant to the investigation and prosecution under the FTRA or of an act constituting unlawful activity;
- shall destroy suspicious transaction report six years from date of report received, or last activity relating to the person or report;
- shall instruct the supervisory authority of an institution to take any steps appropriate, to enforce compliance with the FTRA or to facilitate any investigation by the FIU or a law enforcement agency;
- shall compile statistics and records; may disseminate within Sri Lanka or elsewhere information received, and make recommendations arising out of any information received;
- shall issue, or have the supervisory authority issue, rules and guidelines to institutions relating to customer identification, record keeping, reporting obligations, identification of STRs etc.
- shall issue periodic reports to all Institutions regarding the outcome from reports or information given under the FTRA;
- may obtain further information on parties or transactions referred to in a report;
- may conduct training programmes for Institutions regarding customer identification, record keeping and identification and suspicious transactions;
- may undertake due diligence checks;
- may conduct research into trends and developments relating to money laundering and financing of terrorism and improved ways of detecting, preventing and deterring these activities;
- may educate the public and create awareness on matters relating to ML and TF;
- may disclose as set out in sections 16 and 17 of the FTRA information to other foreign agencies that have powers and duties similar to a FIU;
- may enter into agreements with domestic government institutions or agencies regarding exchange of information.

157. The FTRA thus empowers the FIU to operate as a national information centre to receive, analyse and assess all reports and information from any institutions relating to all suspicious cash and acts constituting an unlawful activity. “Institution” is defined as “any person or body of persons engaged in or carrying out any finance business or designated non-finance business”. The FIU is also empowered to refer any matter, information derived from any report/information to law enforcement agencies for analysis and assessment. It is unknown at this stage if the FIU will also operate as an investigative unit.

Guidelines

158. Under section 22(3) of the draft FTRA, the FIU is empowered with the authority to issue guidelines, directions and regulations to reporting institutions. As the FIU has yet to be made fully operational, however, no guidelines had been issued to reporting parties on the manner and procedures of reporting at time of the on-site visit. Sri Lankan

authorities advised however that guidelines for reporting and reporting procedures will be issued in the near future.

Access to, dissemination and protection of information

159. Section 15 of the FTRA empowers the FIU to have access to financial, administrative and law enforcement for collection of information for the purpose of undertaking its duty and conduct analysis of suspicious transaction reports (STRs). Section 15 also empowers the FIU to obtain further and additional information from reporting parties that needed to properly undertake its functions.

160. Under sections 15 and 16 of the FTRA, the FIU is authorised to disseminate financial information to appropriate law enforcement agencies, including foreign institutions and agencies, for analysis and assessment for the purpose of investigation of suspected ML and FT activities. Section 20 of the FTRA prohibits the disclosure of information by the FIU except for the purpose of his or her duties under the Act, or when lawfully required to do so by a court.

161. As the FIU is not yet in operation, the Evaluation Team was unable to assess effectiveness in this area.

Operational independence and autonomy

162. As noted above, while the powers and functions of the FIU are set out in the FTRA, the FIU actually does not have a statutory basis and is established by regulation. While the Evaluation Team appreciates the reasons for this approach being taken by the Sri Lankan authorities, and notes that the intention is to establish the FIU within the CBSL as an independent entity, the Evaluation Team considers that it would be preferable for the structure, location and reporting lines of the FIU in due course to be given a statutory basis under the FTRA. Such an amendment to the FTRA need not hinder the immediate establishment and effective operation of the FIU, but should be considered in the future when amendments to the FTRA are being contemplated.

163. As the FIU is not yet operational, the Evaluation Team was unable to assess the operational independence and autonomy of the FIU in practice.

Release of reports and statistics

164. Under sections 15(i), (k), (o) and (p) of the FTRA, the FIU is required to compile statistics and records and may disseminate information within Sri Lanka or elsewhere, and make recommendations arising out of any information received. Sections 15(o) and (p) of the FTRA permit the FIU to conduct research into trends and developments in the area of ML and FT and to educate the public and create awareness on matters relating to ML and FT.

165. No statistics or other reports have been issued by the FIU which, as noted above, is yet to be established.

FIU co-operation

166. The Evaluation Team suggests that Sri Lanka consider applying for membership in the Egmont Group once the FIU is fully established and that it should have regard to the Egmont Group Statement of Purpose and its principles for information exchange between FIUs for ML cases.

**Recommendation 30**

Structure, funding, staff, technical and other resources for the FIU

167. As noted above, while the FIU is yet to come into being, consideration has been given by the Sri Lankan Government to establish an FIU in conformity with the international standards. The Sri Lankan Government intends to obtain foreign assistance when necessary to ensure the establishment of a modern effective FIU capable of discharging its responsibilities under the FTRA.

168. The Evaluation Team was informed that the staffing of the FIU will be made up of staff from various government agencies and other competent authorities including the CBSL, Attorney-General's Department and the Police Department. During the on-site visit to various agencies and competent authorities, the Evaluation Team was informed that additional resources and funding would be considered once the decision on the size and structure of FIU was confirmed.

169. At present, the Police Department is the primary law enforcement agency to investigate offences under the FTRA and the PMLA. All potential cases will be sent to the Attorney-General for prosecution. The Criminal Investigation Department (CID) of the Sri Lankan Police Department is at present responsible for all complicated, organized and serious case investigations such as serious fraud cases, murder etc. During the visit to the CID the Evaluation Team was told that officers from CID will be on secondment to work in FIU but the number of personnel involved was yet to be confirmed and would depend on the structure decided for the FIU. The Evaluation Team was informed that additional manpower and resources would be provided to the CID, a separate specialist unit for the investigation of ML and TF offences would be established within the CID if required, and that training would be mandatory for all relevant officers in the Department.

170. The Evaluation Team was advised by competent authorities such as the CBSL and Sri Lankan Police Department that the need for competent staff in the FIU had been acknowledged and identified. All staff will be vetted before being deployed to the FIU. The potential officers from the CID to be posted to FIU will go through additional vetting procedures to ensure high professional standards and integrity are maintained.

Training

171. At present, several officers of the CBSL, the Attorney-General's Department, the Ministry of Finance and the Securities and Exchange Commission of Sri Lanka have been identified and trained on the subjects of money laundering and countering the financing of terrorism. The Evaluation Team was informed that it is possible that some of these officers would be considered for secondment to work in the FIU once it is established. However, at the time of the on-site visit there was no specific plan and schedule in place for further and continuous training for other relevant staff to raise their awareness of the money laundering and FTR legislation.[5]

Statistics

[5] The Sri Lankan authorities subsequently indicated that in the 'Skills and Competency Development Plan' prepared by the Training Department of the CBSL. to identify the training needs and the programs to be implemented during 2006, money laundering has been identified as a useful area for officers of CBSL to be trained in, both locally and abroad. Therefore, the CBSL will consider nominating officers for useful programs on money laundering and related subject areas during 2006.

172. With the FIU not yet in operation, there are no reports or statistics available to measure its effectiveness.

2.5.2 RECOMMENDATIONS AND COMMENTS

173. It is recommended that in order to ensure that the Sri Lanka's FIU is an efficient and effective national information centre, the Sri Lankan authorities must ensure that the FIU:

- is made operational as quickly as possible;
- is set up under statute;
- should be given operational independence to ensure freedom from undue influence or interference;
- should be able to secure extra funding as necessary to expand its resources when necessary in order to ensure effectiveness and efficiency;
- should be provided with adequate and suitable training for staff in combating ML/TF and in financial analysis;
- should ensure staff maintain high professional standards and integrity and that information is securely protected and properly disseminated to appropriate agencies for action;
- should have regular and adequate co-ordination and liaison with domestic law enforcement agencies, financial institutions as well as overseas agencies;
- should apply for membership of the Egmont Group at the appropriate point;
- should work with the supervisors and regulators of all reporting institutions to formulate an effective and consistent guidelines on reporting and identifying of suspicious transactions; and
- should maintain comprehensive statistics on cash and suspicious transaction reports (STRs) together with the detailed breakdown on type of reporting institutions and the number of international assistance received.

2.5.3 COMPLIANCE WITH RECOMMENDATIONS 26, 30 & 32

| | Rating | Summary of factors relevant to s.2.5 underlying overall rating |
|---|---|---|
| **R.26** | **Non-Compliant** | • **The FIU has been formally established but is not in operation as of the date of the report.** |
| **R.30** | **Partially Compliant** | • **A steering committee under the Ministry of Finance has been set up to co-ordinate and oversee the establishment of FIU which will a be multi-agency unit in the CBSL. Training on counter money laundering and terrorist financing has been provided for selected officers who are potential candidates for secondment to work in the FIU when established. It appears that efforts have been made to ensure suitable manpower and resources will be given to the FIU. However, the FIU has yet to come into operation. There is no basis to assess its operational independence and autonomy and its functional effectiveness.** |
| **R.32** | **Non-Compliant** | • **FIU is not yet operational. There are no statistics on STRs available for assessment on level of compliance or the FIU's effectiveness.** |

## 2.6 LAW ENFORCEMENT, PROSECUTION AND OTHER COMPETENT AUTHORITIES – THE FRAMEWORK FOR THE INVESTIGATION AND PROSECUTION OF OFFENCES, AND FOR CONFISCATION AND FREEZING (R.27, 28, 30 & 32)

### 2.6.1 DESCRIPTION AND ANALYSIS

**Recommendation 27**

<u>Overview</u>

174. The legal regime to combat money laundering and the financing of terrorism primarily consists of the following legislation:

i. Prevention of Money Laundering Act, No. 5 of 2006 (PMLA) (passed on 6 March 2006);
ii. Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005;
iii. Financial Transaction Reporting Act, No. 6 of 2006 (FTRA) (passed on 6 March 2006);
iv. Mutual Assistance in Criminal Matters Act, No. 25 of 2002.

175. The Sri Lankan Police Department is the primary organization responsible for to investigating ML and FT offences. Prosecutions are conducted by the Attorney-General on indictment before High Court. When established and operational, the FIU will have a role in coordinating the efforts of the relevant investigative agencies.

176. In general, Sri Lankan investigators conducting investigations into serious and complex crimes regularly consult the Office of the Attorney-General which is the competent body to provide advice and guidance. Under the newly enacted PMLA, a police officer not below the rank of the Superintendent of Police or, in the absence of such an officer, an Assistant Superintendent of Police, may issue a 'Freezing Order' prohibiting any transactions in relation to an account which is believed to have involved in any activity relating to the money laundering offence. The Police Officer issuing the freezing order shall within seven days during the order in force make an application to the High Court to seek confirmation of such freezing order, or if necessary request an extension of the original period of seven days. The freezing order will remain valid until the conclusion of trial if indictment is filed for the offence of money laundering in respect of the account, property which is subject to the freezing order. Confiscation of the property can be made once a conviction of the money laundering offence is secured.

177. The Convention on the Suppression of Terrorist Financing Act came into force in August 2005. The seizure and freezing of funds and proceeds can be initiated upon indictment of any person in the High Court under this Act. The freezing and seizure of funds remain in force until the conclusion of trial. On conviction of any person under this Act, the funds collected can be forfeited to the State.

178. The Police Counter Terrorist Unit (CTU) was established in 1979. Its principal role is to investigate terrorist activities. It currently has 71 officers. The following legislation contains the powers in of arrest, seizure, and confiscation of crime proceeds generated from terrorist activity:

i. Code of Criminal Procedure Act No.15 of 1979;
ii. Prevention of Terrorism Act No. 48 of 1979; and
iii. Public Security Act (section 5).

179. The Police Department advised that there had been arrests of suspects, investigations and detention orders in 721 terrorism cases so far. There may be successful convictions secured in 115 cases but the prosecutions are still pending the Attorney-General's advice. At the time of the evaluation, there had been no seizure/freezing/confiscation of funds and crime proceeds from terrorist activity.

Police Department: Criminal Investigation Department (CID)

180. During the on-site visit, the Evaluation Team was advised that the Criminal Investigation Department (CID) of the Police Department is responsible for the investigation of all serious and complicated cases. There are a number of investigating units within the CID including Fraud squads; Commercial Crime Investigation Units and Special Investigation Units. Police officers at the District and Division level (ie not within the centralised CID) can also investigate the criminal offences within their respective areas of responsibility.

181. As noted previously, criminalisation of money laundering under the PMLA has only just occurred in Sri Lanka. The Police Department advised that if appropriate, designated units in the CID would be duly set up to investigate money laundering and terrorist financing offences to enhance the enforcement capability in relation to ML and TF. The Team was advised that training on investigating techniques in money laundering and terrorist financing will be arranged and additional staffing and resources will be explored when the situation requires it.

182. At present, there is no provision in the PMLA to waive the arrest of suspected persons and/or the seizure of the money for the purpose of identifying persons involved in money laundering activities.

Additional elements

183. The Evaluation Team was advised that special investigation techniques such as undercover operations and surveillance on suspects have been used in various criminal investigations in Sri Lanka. However, there is no provision in the PMLA or the Convention on the Suppression of Terrorist Financing Act to undertake undercover operations or the controlled delivery of the proceeds of crime or funds intended for use in terrorism.

184. Sri Lankan authorities advised that relevant legislation will be formulated in line with the recommendations of the Crime Commission Report of 2004-05 to provide for special investigative techniques to be adopted in the investigation of various offences. Such legislation will involve additional provisions for authorities to conduct controlled delivery, undercover operations and employ electronic surveillance on suspects.

185. The Code of Criminal Procedure contains provisions to engage the Magistrates to assist in investigations by issuing appropriate judicial orders with binding authority.

186. The Mutual Assistance in Criminal Matters Act, No. 25 of 2002 can facilitate the effective investigation of money laundering and financing of terrorism offences by permitting requests for international assistance to obtain relevant evidence and secure the attendance of witnesses.

Statistics

187. The Police Department has yet to set up any investigation teams to specialize in the investigation of money laundering and proceeds of crime. The Counter Terrorist Unit had made no seizures of the proceeds of crime generated from terrorist activity.

188. There are no statistics on co-operative investigations in ML and TF offences with appropriate competent authorities in other countries including the use of special investigative techniques.

189. Given the formative state of Sri Lanka's AML/CFT system, there have been no reviews of ML and FT methods, techniques and trends.

**Recommendation 28**

190. The provisions in the Code of Criminal Procedure Code and the Penal Code contain the necessary provisions to empower law enforcement agencies when conducting investigations into the unlawful activity relating to ML and TF to compel production of documents, to search persons or premises and to seize documents and records held by financial institutions and other business or agency. Additional powers in relation to particular predicate offences are also contained in other statutes, including the Commission of Investigate Allegations of Bribery or Corruption Act No. 19 of 1994, the Bribery Act Chapter 26 and the Exchange Control Act Chapter 423.

191. Under the PMLA and Convention on the Suppression of Terrorist Financing Act, there is provision to empower the freezing and subsequent confiscation of funds and proceeds believed to be generated from unlawful activity relating to ML or TF.

192. The provisions of the Code of Criminal Procedure and several other statutes relating to predicate offences such as the Bribery Act (Chapter 26) also contain the necessary provisions for taking of witnesses' statements for use in investigations and prosecutions of unlawful activity relating to ML and TF and other underlying predicate offence. Further powers are available in the FTRA.

**Recommendation 30: structure, funding, staff and other resources of Law enforcement and prosecution agencies**

193. As mentioned above, the Police Department will be the organization with primary responsibility to investigate ML and TF offences. As noted above, the Police Department indicated that additional units specialized in the investigation of ML and TF offences will be set up within the CID of Police Department if the situation required it, and additional staffing and resources would be considered when required. However, with the PMLA only just enacted, no specialist unit has yet been set up to deal with the investigation of ML offences.

194. In addition to the Police Department, other law enforcement agencies such as the Commission to Investigate Allegations of Corruption and Bribery, the Exchange Control Department of the CBSL and the Customs Department are required to combat ML and TF activities within their areas of responsibility. During the Evaluation Team's meeting with the Commission to Investigate of Allegations of Corruption and Bribery, the Evaluation Team noted that the resources of the Commission appeared somewhat limited. Staff of the Commission's investigation team are seconded from the Police Department. There are about 30 indictments filed in court per year by the Commission with the conviction rate being around 50% only.

195. It is suggested that sufficient staffing and funding be provided to all enforcement agencies responsible for combating of ML and TF activities so as to ensure they are able to fully and effectively perform their respective functions.

Integrity standards and training

196. During the on-site visit, the Evaluation Team was informed that all police officers had gone through an integrity vetting process prior to employment. Officers deployed to work in the CID are selected to ensure that high professional standards and integrity are maintained. Police Officers are also required to observe the provisions of the Official Secrecy Act which govern the conduct of officers in keeping matters confidential. Requests for assistance from developed jurisdictions to train investigators/prosecutors and to raise awareness of judicial officers through the participation of seminar and typologies workshops have been made. Further training will be provided and arranged when the FIU is set up.

197. During the last two years, several seminars (including three with the technical assistance provided by the US Treasury Department) have been held to train the staff of the competent authorities regarding prevention of money laundering and combating terrorism. In view of the activities of the LTTE, all state institutions entrusted with duties relating to combating terrorism are made knowledgeable about the ways and means of addressing the problem. However, there appears to be no plan or schedule for continuous and further training provided to all competent authorities.

Additional elements

198. A Judicial and Legal Reforms Project funded by the World Bank provides training for Sri Lankan judges regarding all financial crimes in addition to other subjects relating legal and judicial reforms including the ML and TF offences.

199. Under section 14(1) of the FTRA every institution is required to appoint a compliance officer and to screen all persons before hiring them as employees. Every institution is also required to train its officers, employees and agents to recognize suspicious transaction.

**Recommendation 32: Statistics – investigations, prosecutions and convictions**

200. With the recent passage of the PMLA, there are no statistics available regarding investigations, prosecutions or convictions for ML. Sri Lankan authorities advised that comprehensive statistics will be maintained by designated authorities as required under the FTRA. At present, different agencies maintain their respective statistics for record and publication. All particulars of financing of terrorism are collected and maintained in the National Intelligence Secretariat.

2.6.2 RECOMMENDATIONS AND COMMENTS

201. It is recommended that:

- coordinated training should be arranged for all enforcement and prosecution agencies in relation to the investigation techniques and prosecution of ML/TF offences;
- the use of controlled delivery and other special investigative techniques be introduced to assist law enforcement agencies to detect ML and FT offences;
- the authorities should consider providing competent authorities with the ability to postpone or waive arrest for the purposes of gathering evidence;

- comprehensive statistics should be maintained on matters relevant to ML and TF so as to ensure the review system can be put in force and an understanding of typologies developed;
- effective national mechanisms should be set up to enable good coordination and cooperation between policy makers, the FIU, law enforcement and other competent authorities in Sri Lanka in combating ML and TF activities;
- FIU and law enforcement agencies and all competent authorities in combating ML and TF should be sufficiently funded, staffed and adequately structured so as to ensure operational independence and that they are able to perform their functions effectively.

### 2.6.3 COMPLIANCE WITH RECOMMENDATION 27, 28, 30 & 32

| | Rating | Summary of factors relevant to s.2.6 underlying overall rating |
|---|---|---|
| **R.27** | **Partially Compliant** | • **Designated law enforcement authorities on ML investigations have yet to be put in place as the PMLA has only just come into force** |
| **R.28** | **Largely Compliant** | • **A number of relevant powers are available in various legislation including the PMLA but the effectiveness of the powers has not been tested and further powers could be made available** |
| **R.30** | **Partially Compliant** | • **The resources to be devoted to combat ML have yet to be finalised given the recent passage of the PMLA** |
| **R.32** | **Non-Compliant** | • **There is no system in place for reviewing the effectiveness of combating ML due to the recent passage of the PMLA. There is no designated agency assigned to maintain statistics on matters relevant to ML** |

## 2.7 CROSS BORDER DECLARATION OR DISCLOSURE (SR.IX)

### 2.7.1 DESCRIPTION AND ANALYSIS

202. The current applicable legislation relating to the cross border transportation of currency and bearer negotiable instruments is the Exchange Control Act, the Customs Ordinance and the newly enacted FTRA.

203. Sections 21 and 22 of the Exchange Control Act deal respectively with the restrictions on the import and export of Sri Lankan and foreign currency notes, gold and negotiable bearer instruments in general. (The definition of the term ‘currency’ in section 54(1) of the Exchange Control Act includes coins, currency notes, bank notes, postal orders, money orders, cheques, drafts, traveller’s cheques, letters of credit, bills of exchange and promissory notes.) Sections 25, 26, 27 and 28 of the newly enacted FTRA also deal with the restrictions and liabilities on the import and export of cash or negotiable bearer instruments in general.

204. Under the Exchange Control Act, any person making physical cross border transfer of foreign currency of the equivalent of US$10,000 or more is required to declare

it at the Customs barrier. Import and export of certain prescribed currencies is not permitted. Failure to declare currencies to the equivalent of US$10,000 or more when physically carrying such currency through Customs at entry to or exit from the country is punishable under the Exchange Control Act and FTRA. Under section 51(4) of the Exchange Control Act, where the offence convicted is concerned with any gold, currency, security goods or other property, the court may, if it thinks fit to do so, order the gold, currency, security goods, or property to be forfeited; and any gold, currency, security goods, or property forfeited under this subsection shall be dealt with or disposed of in such manner as the Minister may direct. Under section 27 of the FTRA, any person who leaves or arrives in Sri Lanka with more than the above prescribed sum in cash or negotiable bearer instruments on his or her person or in his or her luggage without first having reported the fact to the relevant authority is guilty of an offence and shall be punishable on conviction with a fine not exceeding one hundred thousand rupees or imprisonment of either description for a term not exceeding one year, or to both such fine and imprisonment.

205. Although physical cross border transfer of foreign currency of less than the threshold limit of US$10,000 does not require a voluntary declaration under the Exchange Control Act, the Customs authorities are in a position to make a specific request for a person carrying foreign currency to make a declaration, even if the value of currency so carried is less than the US$10,000. This procedure may be followed if the Customs Department has been alerted that the currency carried is associated with any suspicious activity. A person who fails to comply with such a specific request made by Customs is punishable under the Customs Ordinance (read with the Exchange Control Act).

206. However, at this point there is no requirement for the Customs Department to maintain any records in relation to the cross border transfer of funds. Since the FIU has yet to be established, there is no guideline on the reporting of suspicious cross-border transportation incidents or information on declaration/disclosure.

207. During the meeting with the Customs Department, the Evaluation Team was informed that if a false declaration or a failure to declare incident is noted, the Customs Department is not required to make enquiry with the person making such physical cross-border transportation as to the origin of the currency or the intended use, nor will the case be referred to other law enforcement agencies such as the Police Department for follow-up investigation; it will merely be treated as a Customs violation. There is no specific mechanism in place for the co-ordination among Customs Department and other agencies in the implementation of cross border currency transportation relating to terrorist activity.

208. Statistics on detection of smuggling of currency through Bandaranaike International Airport in Colombo between June 2004 and September 2005 were provided by the Customs Department. There were total 24 detection cases involving the forfeiture of amount ranging from £14,280 to US$16,117,649 in various currencies.

209. When issuing foreign currency for travel and other purposes, commercial banks in Sri Lanka are not permitted to issue more than US$500 in currency notes without the prior approval of the CBSL. Any amount issued in excess of this amount has to be in the form of travellers cheques or bank drafts etc. Commercial banks are required to report all transactions pertaining to the sale and purchase of foreign currency to the Department of Exchange Control in the CBSL on prescribed forms, irrespective of the amount involved. All transactions in which the amount involved is the equivalent US$5000 or more have to be reported to the CBSL on a daily basis. Information reported to the CBSL when foreign currency is purchased from a commercial bank should include the name, address, identity number/passport number of the purchaser.

210. The Customs Department advised that it does not have regular co-operation with other countries but does have adequate contact with the Customs Authority in India in the exchange of information on cross border transportation of currency.

### 2.7.2 RECOMMENDATIONS AND COMMENTS

211. It is recommended that :

- There should be mechanism set up to allow suspicious cross border currency transportation incidents to be investigated by competent authorities in relation to the origin of currency and its intended use.
- Cross border transportation of precious metals or stones should be declared with information made available to the FIU.
- A mechanism to maintain comprehensive statistics on cross border transportation of currency should be established.
- The Customs Department should establish relationships to enhance coordination and contact with other enforcement agencies both domestically and overseas for intelligence sharing and cooperation on cross border transportation reports.

### 2.7.3 COMPLIANCE WITH SPECIAL RECOMMENDATIONS IX

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **SR.IX** | **Non-compliant** | • **There is a declaration system in place for cross border transportation of currency but with no mechanism to ascertain origin of the currency and its intended use in relation to money laundering or terrorist activity**<br>• **There is no mechanism in place to maintain comprehensive statistics or to pass on information relating to declarations of cross border transportation to the FIU when established** |

# 3 PREVENTIVE MEASURES – FINANCIAL INSTITUTIONS

## *Customer Due Diligence & Record Keeping*

**GENERAL**

212. The planned AML measures applicable to Sri Lanka's financial institutions are contained in the Financial Transactions Reports Act (FTRA). Obligations under the FTRA will be applicable to "institutions", a term that includes persons and entities engaged in finance business and designated non-finance businesses.

213. "Finance business" includes:

- banking business as defined in the Banking Act;
- finance business as defined in the Finance Companies Act;
- lending, including consumer credit, mortgage, factoring and financing of commercial transactions;
- financial leasing;
- the transfer of money or value;
- money and currency changing services;
- issuing and managing means of payment;
- issuing financial guarantees and commitments;
- trading in money market instruments, foreign exchange, exchange interest rate and index instruments, commodity futures trading and transferable securities; and
- participating in securities issue;

214. "Designated non-finance business" includes, aside from DNFBPs discussed in section 4 of this report:

- individual and collective portfolio management;
- investing, administering or managing funds or money;
- safekeeping and administration of cash or liquid securities;
- safe custody services;
- underwriting and placement of insurance, as well as insurance intermediation by agents and brokers; and
- trustee administration or investment management of a superannuation scheme.

215. The FTRA sets out customer identification, record-keeping, ongoing due diligence and suspicious reporting requirements for institutions. As noted above, the FTRA was passed by Parliament on 6 March 2006 but is not yet in force, as all the required implementing regulations have yet to be drafted and promulgated.

216. It should however be noted that on 23 March 2006, after the on-site visit, the President of Sri Lanka issued a Regulation (the Financial Transactions Reporting Regulations No. 1 of 2006) and an Order for the purposes of the section 6 of the FTRA, which requires Institutions to reports cash and electronic funds transfers (EFTs) to the FIU. The Regulation and Order set the threshold for reporting both cash transactions and EFTs at 500,000 rupees, or its equivalent in any foreign currency. (500,000 Sri Lankan rupees is roughly equivalent to US $5,000).

## 3.1 RISK OF MONEY LAUNDERING OR TERRORIST FINANCING

217. The FTRA does not distinguish between financial institutions or specify AML/CFT obligations for financial institutions on the basis of risk. The definition of "institution" under the FTRA is mostly drawn out of the definition of "financial institution" and "designated non-financial business and professions" under the FATF Recommendations. The authorities have not sought to implement a regime that consciously excludes particular types of business from the minimum requirements on the basis of a risk assessment. Under the FTRA, it appears to be that the same minimum standards will be applied to all relevant financial institutions. The FTRA provides for the issuance regulations in respect of the identification of appropriate risk management systems consistent with the Recommendations of the FATF, but the criteria for such risk assessments have yet to be determined.

## 3.2 CUSTOMER DUE DILIGENCE, INCLUDING ENHANCED OR REDUCED MEASURES (R.5 TO 8)

### 3.2.1 DESCRIPTION AND ANALYSIS

***Recommendation 5***

218. In 1995, Sri Lanka repealed a provision under the Banking Act that allowed licensed commercial banks and licensed specialized banks to maintain secret numbered accounts. Although the Banking Act does not explicitly prohibit such accounts, subsection 2(1) of the FTRA, prohibits financial institutions from opening or maintaining an account where the account holder cannot be identified, including an anonymous account or a numbered account. This prohibition also applies to accounts which the financial institution knows are under false or fictitious names.

219. Pending the issuance of rules under the FTRA, there are currently no enforceable CDD requirements applicable to all financial institutions. In December 2001, the CBSL issued a Guideline on Know Your Customer and Due Diligence to licensed commercial banks and licensed specialised banks. Finance Companies were also advised to implement KYC procedures for customers that purchase certificates of deposits. The Guideline provides recommendations but it is not mandatory.

220. The Guideline recommends that the identity of holders of personal accounts be verified by referring to an identity document. For corporate customers, a document establishing the legal status should be obtained, and the identity of the directors should be verified. The Guideline recommends more stringent measures in certain situations, such as one-off transactions for non-account holders, when there is no face-to-face contact, and when a large electronic remittance is conducted. However, this does not require a risk assessment by the institution. The Guideline does suggest however, that an application for account opening that may subject the institution to a reputational risk should be referred to an officer of higher authority.

221. Every citizen of Sri Lanka must possess a National Identity Card, issued to them by the Registrar of Persons. Under a regulation made under subsection 100(1) of the Inland Revenue Act, individuals are required to submit their National Identity Card Number to open a bank account. There is no explicit requirement to present the card, however. All companies are required to provide the registration number issued by the Registrar of Companies.

222. The Public Debt Department of the CBSL has issued a Code of Conduct for primary dealers. The code applies to transaction in government securities conducted by dealers with the CBSL or with institutional and retail clients. The code requires primary

dealers to obtain adequate documentation on the identity of their customers, but does not specify the types of verification and documentation that should be used.

223. The Securities and Exchange Commission of Sri Lanka Rules, 2001 require that every licensed stock broker or stock dealer maintain a register of transaction for every client and a client ledger. However, neither the Securities and Exchange Commission of Sri Lanka Act nor the rules or regulations issued under this statute include any customer identity verification requirements.

224. Rules issued by the Central Depository Systems (CDS) require that licensed participant stock brokers or dealers, or participant banks, when opening a securities account, provide the CDS with identifying information on the customer and verify customer identity by examining and keeping a copy of the National Identity Card or passport. All licensed stock brokers or dealers are participants to the CDS, and its rules are approved by the SEC.

225. The Regulation of Insurance Industry Act requires insurers to keep a record of, for every policy issued, the name and address of the policy holder, as well as the name and address of every person who makes a claim. The legislation allows an insurer to request a proof of age to determine whether an application for insurance is fraudulent. There is, however no obligation for insurers, insurance brokers or insurance agents to verify the identity of policy holders or claimants. Although representatives of the Insurance Board of Sri Lanka noted to the team of assessors that they inquire about the "know your customer " procedures of insurers in the course of their inspections, the Board has not issued any circular or directive on this issue.

226. Part I of the FTRA sets out CDD requirements that will be applicable to "institutions", including persons and entities engaged in finance business and designated non-finance businesses. Subsection 2(2) of the FTRA sets out the requirement to verify the identity of customers using official documents or other reliable and independent source documents.

227. The trigger for identity verification will be:

- when entering into a business relationship;
- conducting a one-off transaction;
- carrying an electronic funds transfer;
- when the institution suspects unlawful activity; or
- when there are doubts about the veracity of customer identification;

228. The FTRA allows a three-year phase-in period for the identification of existing customers at the time of coming into force of the provisions. The FTRA provides for the issuance of rules by the (yet to be created) FIU to set out the specifics of the requirements, such as the types of documents, timing and thresholds.

229. Section 3 of the FTRA prohibits institutions from conducting transactions where the customer was not satisfactorily identified, unless directed otherwise by the FIU, and requires the institution to report the attempted transaction to the FIU. Section 5 includes a requirement to conduct ongoing due diligence of the business relationship and conduct ongoing scrutiny of the transactions. This does not include keeping customer information up-to-date.

230. Some risk-based elements of the CDD procedures are outlined in subsection 29(2) of the FTRA. This subsection provides that regulations will be issued in respect of

the identification of appropriate risk management systems consistent with the Recommendations of the FATF, including the categorization of customers and the manner in which senior management approval is to be obtained before establishing business relationships with high-risk customers. The legislation does not specify whether enhanced CDD and monitoring would be required for customer categorized as high-risk. There are no provisions in respect of low-risk customers or transactions.

231. There is no requirement under the FTRA to determine whether the customer is acting on behalf of another person and to identify that person. Nor is there a requirement under the FTRA to understand the ownership and control of legal entities or identify their beneficial owners. Although it is a common business practice for financial institutions in Sri Lanka, there is no requirement under the FTRA to obtain information on the purpose and intended nature of the business relationship.

***Recommendation 6***

232. Foreign banks established in Sri Lanka have, as part of their AML/CFT procedures, measures to identity and conduct enhanced due diligence on customers who are politically exposed persons (PEPs). There is however, no requirement for financial institutions to identify or take any specific measures in respect of PEPs, either domestic or foreign. Neither the FTRA nor the KYC Guideline issued by the CBSL in December 2001 refers to PEPs. Sri Lanka has signed and ratified, in March 2004, the United Nations Convention against Corruption, but has not implemented the elements of the Convention applicable to PEPs.

***Recommendation 7***

233. Representatives of the licensed commercial banks met by the Evaluation Team indicated that, as a matter of business practice, they verify that the foreign banks with which they enter into a cross-border correspondent banking relationship with are reputable institutions. Such verification can be done through their existing correspondent banks. However, there are no requirements for due diligence or other procedures for financial institutions that enter into such relationships. Institutions met by the Evaluation Team indicated that payable-through accounts are not offered by banks in Sri Lanka.

***Recommendation 8***

234. A significant proportion of financial transactions in Sri Lanka are still cash-based. The use of new technologies, such as the Internet, in banking and other financial services, although growing, is not widespread. Non-face-to-face transactions, although not prohibited by law, are therefore not common.

235. The financial institutions and intermediaries met by the Evaluation Team indicated that they do not, as a business practice, open accounts or start business relationships with residents of Sri Lanka without meeting them in person. It may happen, however, when they deal with non-residents. Some banks rely on their correspondent or on the embassy of Sri Lanka abroad to perform customer due diligence. Once the business relationship is established and identity verified, certain institutions allow their customers to conduct transactions over the Internet or by phone.

236. There are no enforceable requirements in respect of measures to prevent the misuse of technological developments in the financial sector and non-face-to face business relationships. Subsection 29(2) of the FTRA provides authority for the issuance of regulations in respect the establishment by financial institutions of appropriate risk management systems consistent with the recommendations of the FATF. There are

however, no provisions in respect of measures to prevent the misuse of technological developments.

237. The KYC Guideline recommends that banks have more stringent customer identification policies when there is no face-to-face contact with the customer.

238. Subsection 2(2) of the FTRA requires the verification of customer identification data using an official document or other independent source document, but it does not specify CDD measures when the customer is not physically present.

### 3.2.2 RECOMMENDATIONS AND COMMENTS

239. The issuance in 2001 of the KYC guideline by the CBSL, although not mandatory, has prompted many banks and finance companies in Sri Lanka to implement procedures to identify their customers. This has created awareness in the financial sector on the importance of such measures. However, aside from the rules applicable to securities accounts and primary dealers, there are no mandatory CDD requirements in force at the moment.

240. The FTRA contains the basic CDD requirements to identify and verify the identity of customers and conduct ongoing due diligence. The activities included in the definition of “finance business” and “designated non-finance business” under the FTRA cover all the activities listed under “financial institutions” in the FATF 40 Recommendations. The transactions and circumstances that trigger the CDD requirements are also consistent with those set out in FATF Recommendation 5.

241. However, the CDD provisions are not yet fully in force and regulations have to be issued to set out some of the specifics of the CDD obligations. Although some of the institutions met by the Evaluation Team were aware that the FTRA would include mandatory customer due diligence provisions, considerable outreach and guidance will be required to ensure effective compliance in all sectors.

242. There are some deficiencies and unspecified elements in the CDD framework, which should be addressed.

243. It is recommended that the FTRA or its regulations set out explicit requirements in the following areas:

- ensure that customer information is kept up-to-date;
- determine whether the customer is acting on behalf of another person;
- obtain and verify information on the beneficial owners of accounts and transactions;
- for customers that are legal persons, understand the ownership and control structure and determine who are the natural persons that ultimately own or control the customer.

244. It is recommended that the FTRA, its regulations or guidelines set out explicit requirements in the following areas:

- obtain information from the customer on the purpose and intended nature of the business relationship;
- perform enhanced due diligence for higher risk categories of customers, business relationships, and transactions;
- consider circumstances where reduced CDD measures would be acceptable; and
- set out an explicit timing for customer due diligence measures.

245. With regard to PEPs, it is recommended that the FTRA or regulations include requirements for financial institutions to have policies and procedures applicable to customers or beneficial owners that are PEPs, including obtaining senior management approval for establishing business relationships with a PEP, establishing the source of wealth and the source of funds and conducting enhanced ongoing monitoring.

246. It is recommended that specific legislation be introduced for correspondent relationship obligations. The requirements should include gathering sufficient information about a respondent institution assess the respondent institution's AML/CFT controls, obtain approval from senior management before establishing new correspondent relationships, and document the respective AML/CFT responsibilities of each institution.

247. It is also recommended that Sri Lanka establish legislative requirements for financial institutions to have policies and procedures to address risks arising from new or developing technologies, in particular Internet accounts. This would include specific CDD provisions when the customer is not physically present.

### 3.2.3 COMPLIANCE WITH RECOMMENDATIONS 5 TO 8

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.5** | **Non-compliant** | • **Aside from rules applicable to securities accounts and primary dealers, there are no mandatory CDD requirements in force.**<br>• **The KYC guideline includes provisions for the identification of customers that are natural persons or entities, but the guideline is not enforceable.**<br>• **The FTRA covers the full range of financial institutions under the FATF standards, but is not yet in force.**<br>• **The FTRA is not specific about measures to be taken for customers that are individuals vs. measures for corporations and other entities.**<br>• **There is no requirement for the identification of beneficial owners or third parties or to understand the ownership and control structure of the customer.**<br>• **There is no requirement to obtain information on the purpose and nature of the relationship and update customer information.**<br>• **Provision in respect of the identification of existing customers will be prescribed in regulations and are not in force** |
| **R.6** | **Non-compliant** | • **There is no legislative, regulatory or other enforceable requirement in respect of politically exposed persons** |
| **R.7** | **Non-compliant** | • **There is no legislative, regulatory or other enforceable requirement in respect of correspondent banking relationships.** |

| R.8 | Non-compliant | • **There is no requirement for measures in respect of technological development or non-face-to-face business relationships.** |
|---|---|---|

## 3.3 THIRD PARTIES AND INTRODUCED BUSINESS (R.9)

### 3.3.1 DESCRIPTION AND ANALYSIS

248. There is no prohibition in law for financial institutions in Sri Lanka to enter into a business relationship with a customer through an intermediary or other third party. However, financial institutions met by the Evaluation Team indicated that as a business practice they require their customers that are resident in Sri Lanka to be physically present when opening an account, and therefore would not initiate business relationships through third parties and introducers. Certain institutions that have customers outside Sri Lanka rely on an agent such as a correspondent bank or an embassy to conduct due diligence on the customer.

249. Neither the KYC Guideline nor the FTRA specifies the application of the CDD requirements when business relationships are initiated through third parties and introducers. The FTRA requires institutions to obtain and verify customer information, but does not specify whether these measures must it all cases be performed directly by the institution, as opposed to relying on another person or entity.

### 3.3.2 RECOMMENDATIONS AND COMMENTS

250. It is recommended that FTRA or regulations spell out specific requirements that financial institutions should follow, in the absence of contractual arrangements, when they rely on a third party to perform CDD. The provisions should specify that financial institutions:

- obtain the necessary customer information from the third party immediately upon the establishment of business relationship;
- satisfy themselves that the third party is able to provide the CDD documentation to them on a timely basis upon request;
- satisfy themselves that the third party is appropriately regulated and supervised and has measures in place to comply with the CDD requirements (e.g., it is located in a country that adequately applies the FATF Recommendations); and
- remain ultimately responsible for the proper performance of CDD measures and compliance with the FTRA.

### 3.3.3 COMPLIANCE WITH RECOMMENDATION 9

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.9** | **Non-compliant** | • The FTRA does not specify the application of the CDD requirements when business relationships are initiated through third parties and introducers, or the responsibility for meeting the requirements. |

### 3.4 FINANCIAL INSTITUTION SECRECY OR CONFIDENTIALITY (R.4)

3.4.1 DESCRIPTION AND ANALYSIS

***Recommendation 4***

251. Generally, Sri Lanka's financial institution secrecy laws do not inhibit implementation of the FATF Recommendations. The passage and implementation of the FTRA will further clarify the situation. However, there are currently no clear pathways under which information can be readily shared between competent authorities either domestically or internationally.

*Banking Sector*

Existing Provisions

252. Section 77 of the Banking Act states:

> *"Every director, manager, officer or other person employed in the business of any licensed commercial bank or licensed specialized bank shall observe strict secrecy in respect of all transactions of the bank, its customers and the state of accounts of any person and all matters relating thereto and shall not reveal any such matter except—*
>
> *(a) when required to do so—*
>
> *(i) by a court of law;*
>
> *(ii) by the person to whom such matters relates;*
>
> *(b) in the performance of the duties of the director, manager, officer or other person; or*
>
> *(c) in order to comply with any of the provisions of this Act or any other written law.*
>
> *(2) Every director, manager, officer or person employed in the business of a licensed commercial bank or licensed specialized bank shall before entering upon the duties, sign a declaration pledging himself to observe strict secrecy in accordance with subsection (1).*
>
> *(3) The provisions of subsections (1) and (2) shall not prohibit a bank from providing in good faith to another bank on request an opinion or reference relating to a customer in accordance with customary banking practice."*

253. Sri Lankan authorities advised that, in practice, there may be circumstances where information may have to be provided in order to comply with court orders. There is however no record keeping of such circumstances.

254. There are no legal provisions under which the CBSL or any other authority is empowered to share information between competent authorities, either domestically or internationally; or share information between financial institutions.

*Non-Banking Sector*

255. During discussions with the officials of the Non-Banking Financial Companies Department of the CBSL, it was clarified that there are no provisions in the Finance Companies Act or Finance Leasing Act regarding preservation of secrecy in respect of customers of finance companies or leasing companies.

*Securities Sector*

256. In terms of section 45 of the Securities and Exchange Commission of Sri Lanka Act, the Securities and Exchange Commission (SEC) can require any person to furnish documents or information by issuing a notice. It shall be the duty of any person who

receives the notice, notwithstanding anything to the contrary in any written law, to comply with the requirements of such a notice. Where in compliance with such a notice such person discloses any information or produces any document which he is prohibited from doing under any written law such disclosure or production shall, notwithstanding anything to the contrary in such written law, not be deemed to be a contravention of the provision of such written law. However, no information thus furnished shall be published or communicated by the Commission to any other person, except with the consent of the person furnishing such information.

257. Market intermediaries are required to maintain a record of all transactions relating to a client spanning the immediately preceding period of at least six years. They are also required to have a suitable information recording and retrieval system and maintain such information for inspection by the SEC. The Evaluation Team was informed that the confidentiality of all information, relating to the client, and including such client's identity and transactions carried out for such client, shall be ensured at all times. There appears to be presently no explicit requirement for disclosing information to competent authorities, however the Sri Lankan authorities indicated that market intermediaries could be directed to provide the SEC with all such client information where such information is required for an investigation or inquiry carried out by the SEC and in terms of sections 15 and 22 of the FTRA.

*Insurance Sector*

258. The Regulation of Insurance Industry Act, 2000 does not contain any provisions in respect of secrecy obligation of the Insurance Companies, Insurance Agents or Insurance Brokers.

*Position in terms of newly passed Acts*

259. The FTRA specifically provides in section 6 that financial institutions shall report to the FIU cash transactions/Electronic Fund Transfers above a certain limit to be prescribed by order published in the Gazette (now set at 500,000 Sri Lankan rupees, roughly US$5000). Further, section 7 of the FTRA requires financial institutions to report suspicious transactions. Section 16 of the FTRA provides that the FIU may disclose any report or information to an institution or agency of a foreign state or of an international organization or body or other institutions or agency established the Government of foreign States that has powers and duties similar to those of the FIUs on such term and condition as are set out in the agreement or arrangement between the FIUs regarding the exchange of such information under section 16.

260. Section 31 of the FTRA requires every institution (meaning any person or a body of persons engaged in carrying out any finance business or a designated non-finance business) to comply with the requirements of the Act notwithstanding any obligation as to secrecy or other restriction on the disclosure of information imposed by any written law or otherwise.

261. Further, section 16 of PMLA states that the provisions regarding freezing and forfeiture of assets in relation to the offences of money laundering shall have effect notwithstanding any obligation as to secrecy or other restriction upon the disclosure of information imposed by any written law or otherwise and accordingly and disclosure of information by any person in compliance with the provisions regarding freezing etc. shall be deemed not be a contravention of such obligation or restriction.

### 3.4.2 RECOMMENDATIONS AND COMMENTS

262. As far as the banks are concerned, though secrecy obligations have been imposed there are nonetheless provisions that permit the collection of information by the competent authorities. Insurance companies, finance companies and financial leasing companies are not under secrecy obligations. Secrecy obligations in respect of security market intermediaries do no prevent the collection of information by the SEC. There do not appear to be any secrecy obligations for insurance companies. However, there are no express provisions under which the information can be shared between competent authorities either domestically or internationally. It is recommended that this be remedied through legislative amendment.

### 3.4.3 COMPLIANCE WITH RECOMMENDATION 4

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.4** | **Largely Compliant** | **Laws do not prohibit collection of information by competent authorities but there are no provisions under which the information can be shared between competent authorities either domestically or internationally.** |

## 3.5 RECORD KEEPING AND WIRE TRANSFER RULES (R.10 & SR.VII)

### 3.5.1 DESCRIPTION AND ANALYSIS

***Recommendation 10***

263. The Sri Lankan authorities stated in their response to the mutual evaluation questionnaire that in view of the Prescription Ordinance of Sri Lanka, all banks maintain documents for a period of six years. The relevant section of the Prescription Ordinance reads as follows:

> *" Section 6 : No action shall be maintainable upon any deed for establishing a partnership , or upon any promissory note or bill of exchange, or upon any written security not falling within description of instruments set forth in section 5 ( which concerns Mortgage debt or bond prescribed after ten years) , unless such action shall be brought within six years from the date of the breach of such partnership deed or such written promise, contract, bargain, or agreement, or other written security, or form the date when such note or bill shall have become due, or of the last payment of interest thereon."*

264. It is observed that the Prescription Ordinance concerns itself with the limitation on the period within which action is to be brought by the bank in case of promissory note etc. It does not however cast any explicit obligation on banks to maintain records of all transactions.

265. In terms of the Finance Companies (Deposits) Direction No. 1 of 2005 dated 31 January 2005, finance companies are required to maintain records of account number; name; address; the national identity card number or the passport number of each depositor; principal amount; date of deposit / date of renewal; duration and maturity of deposit; rate of interest and the basis of payment of interest (monthly or at maturity); the amount of accrued interest; date and amount of each payment and the serial number of certificate in respect of each time deposit. For savings deposits, it is required that every finance company shall maintain a record of the name, date of birth, national identity card number and the address of the account holder; account number; date, amount and description of every credit or debit made to the savings account; and outstanding balance

at any particular time. Finance Companies have also been informed that they may satisfy themselves with KYC Rules in respect of customers who invest in Certificates of Deposits (CDs) with finance companies, and maintain records of adequate details pertaining to customer identification of the persons making investment in CDs with the finance companies, and of persons encashing the CDs from the finance companies at the date of maturity.

266. Further, several circulars have been issued by CBSL to finance companies on various dates including 25 January 2002, 8 February 2002, 3 September 2002 and 27 March 2003 that require details with regards to attempts made to make deposits by persons and entities included in the list prepared in pursuance to Security Council Resolution 1267(1999), 1333(2000) and 1390(2002) should be sent to the Department of Supervision of Non-Bank Financial Institutions.

267. Discussion across a cross-section of banks and financial intermediaries met by the Evaluation Team indicated that generally there is an understanding that all records including the instruments and vouchers are required to be maintained for at least a period of six years.

268. Section 4 of the FTRA requires every institution to maintain records of transactions and of correspondence relating to transactions and records of all reports furnished to the FIU for a period of six years from the date of transaction, correspondence or the furnishing of the report.

269. No material was provided that would indicate the existence of any regulation or direction to the effect that transaction records maintained should be sufficient to permit reconstruction of individual transactions. Section 4 of the FTRA does however require that the records required to be maintained under the section shall contain particulars sufficient to identify the name, address and occupation of each person conducting the transaction, the person on whose behalf the transaction is being conducted, nature and date of transaction, type and amount of currency involved, parties to the transaction, the name and address of the employee who prepares the record and such other information as may be specified in the rules issued by the FIU.

270. Sri Lankan authorities indicated that the requirements of the Banking Act, the Finance Companies Act and the Prescription Ordinance ensure the proper maintenance of records.

271. In relation to the insurance sector, section 28 of the Regulation of Insurance Industry Act No 43 of 2000 requires insurers to keep a register or record of every insurance policy issued that includes the name and address of the policy holder, the date the policy was issued, as well as details of any transfer, assignment or nomination. Insurers are also required to keep a record of every claim, including the name and address of every person who makes a claim and the date of the claim and the date of settlement or rejection. The legislation does not specify the period of time for which the records must be kept. In addition to section 28, section 95 of the Act requires every insurer and broker to maintain a register of policies in such form that may be determine by the Board by rules made in that behalf. The form determined by the Board is published in Gazette Extraordinary No. 1412/30 of 29 September 2005.

272. In relation to stockbrokers, section 7(2) of the Securities and Exchange Commission of Sri Lanka Rules, 2001 require that every licensed stock broker or stock dealer maintain, for a period of five years, a register of transaction for every client and a client ledger. This provision does not specify which elements of client information should be included in the records.

273. Section 4 of the newly enacted FTRA requires that records of identity obtained in terms of section 2 of the FTRA be retained for a period of six years from the date of closure of the account or cessation of the business relationship. In case specific directions are issued by the FIU, such records shall be required to be maintained for a longer period.

274. Section 4 of the FTRA provides that where any record is required to be maintained under the Act, it shall be maintained in a manner and form that will enable an Institution to comply immediately with requests for information from the FIU or a law enforcement agency and a copy of it may be kept in a machine-readable form if a paper copy can be readily produced from it or in an electronic form, if a paper copy can be readily produced from it and an electronic signature of the person who keeps the records is retained for purposes of verification. The Act also requires that the records maintained shall be made available upon request to the FIU for purposes of ensuring compliance with the Act.

275. Though not specifically provided in laws or enforceable regulations, the financial sector does maintain, generally, records for a period of six years.

***Special Recommendation VII***

276. During discussion with the Exchange Control Department of the CBSL, it was explained that only Authorised Dealers (which are all licensed commercial banks with the exception of one licensed specialised bank) can send wire transfers outside the country. In order to do so, it is necessary for the purchaser to fill in 'Form 1' which contains details including name, address, National Identity Card (NIC) number, Passport number, Income Tax file number, name and address of the beneficiary and the purpose of the remittance. Originals of the forms are submitted to the CBSL while the bank retains the duplicate.

277. For inward remittances, the Authorised Dealers are required to fill in 'Form 2' which contains details of name, address and NIC number of the beneficiary, purpose of the inward remittance, currency and the amount, as well as the name and address of the remitter. However, Form 2 does not contain details of the remitter's account number, his national identity number or customer identification number or date and place of birth. The Sri Lankan authorities advised that in the case of any suspicious remittance, the remitter's account number and other identification details could be traced from the accompanying Swift message. It is mandatory for the banks to preserve SWIFT messages for a period of six years.

278. From discussions, it appeared that no such requirements have been made compulsory for domestic wire transfers.

279. No specific requirement to include full originator information was indicated to the Evaluation Team. During discussions with the Exchange Control Department and several banks, it was stated that the originator information forms a part of the SWIFT message and is sent along with the wire transfer. As far as batch transfers are concerned, the practice is not widely prevalent in the country and no instructions have been issued in this regard.

280. No specific instruction to the banks to include the originator information in domestic wire transfers has been issued.

281. During discussions, it appeared that batch transfers were not widely prevalent in Sri Lanka and no specific instructions had been issued in this regard.

282. As cross border transfers can be made only by Authorised Dealers, it appears that a chain of remittances involving several financial intermediaries is uncommon. Further, it appears that Form 1, which must be completed when purchasing foreign exchange, must be signed personally by the purchaser of the foreign exchange.

283. No specific instructions have been issued to Authorised dealers to include the originator information in the wire transfer. No de minimis threshold is followed. Cross border transfers require the collection and maintenance of originator information about all remittances irrespective of the amount involved.

284. During discussions with the Exchange Control Department it was indicated that for cross border inward wire transfers, banks are required to necessarily obtain the information regarding the name and address of the remitter. Discussions also indicated that the information is generally available in the SWIFT formats. However, there was no indication regarding the making of a suspicious transaction report or to terminate relationships with financial institutions that do not comply with SRVII.

285. Discussions with the officials of two locally incorporated banks and a foreign bank indicated that banks fill in the originator information fields in the SWIFT formats while sending outward wire transfers. If the inward wire transfer does not contain the originator information, they revert to the sender and if the information is not forthcoming the remittance is sent back.

286. The FTRA does not provide for making a suspicious transaction report to the FIU if an incoming wire transfer is not accompanied by the originator information and if even on request to the financial institution that sent the wire transfer, the missing information is not forthcoming, a suspicious transaction report may be considered.

287. No specific instructions have been issued by the CBSL or other regulators in respect of implementing SR VII and monitoring its compliance. In addition, no specific criminal, civil or administrative sanctions are available for non-compliance of obligations under SR. VII.

### 3.5.2 RECOMMENDATIONS AND COMMENTS

288. The FTRA now provides for maintenance and production of records of transactions by financial institutions. However the requirement that the records maintained should be sufficient to reconstruct the individual transactions has not been specifically provided for. To address the issues identified Sri Lanka should include obligations in law or regulations requiring financial institutions to:

- maintain all necessary records on transactions, both domestic and international, for at least five years following completion of the transaction (or longer if requested by a competent authority in specific cases and upon proper authority) and records should be sufficient to permit reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity.
- maintain records including account files and business correspondence for at least five years following the termination of an account or business relationship (or longer if requested by a competent authority in specific cases upon proper authority).

289. The existence of exchange control in Sri Lanka makes it necessary for banks to obtain detailed information about the remitter in the case of outward cross-border wire transfers but only limited information is required to be obtained in respect of remitter in the case of inward remittances. There is no requirement under either a law or enforceable

regulations that originator information must be included in the outward and inward wire transfers. No laws or regulations either make collection of originator information necessary or require originator information to be transmitted in the case of domestic wire transfers.

290. To effectively implement AML/CFT controls on wire transfers, Sri Lanka should amend the Act or issue regulations and enforceable guidelines to completely implement all elements of SR VII and the Interpretative Note, including

- making collection and transmission of required originator information mandatory in the case of all wire transfers.
- providing guidance on the course of action that a financial institution should take if the originator information has not been provided in the inward wire transfers.

3.5.3 COMPLIANCE WITH RECOMMENDATION 10 AND SPECIAL RECOMMENDATION VII

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.10** | **Partially Compliant** | • **Maintenance of records is still not a requirement under existing laws or enforceable regulations as the obligations under the FTRA are not yet operational.**<br>• **Generally in practice all financial institutions maintain records for a period of six years.** |
| **SR.VII** | **Partially compliant** | • **No specific laws or enforceable regulations exist in respect of inclusion of originator information in wire transfers. The requirements under the Exchange Control Act do not require that originator information be transmitted nor do they collect sufficient information for inward remittance. Further these are not applicable to domestic wire transfers.** |

***Unusual and Suspicious Transactions***

## 3.6 MONITORING OF TRANSACTIONS AND RELATIONSHIPS (R.11 & 21)

### 3.6.1 DESCRIPTION AND ANALYSIS

291. As noted previously, the Prevention of Money Laundering Act, 2005 (PMLA) and Financial Transactions Reporting Acts, 2006 (FTRA) have only very recently been passed. Monitoring of transactions and relationships needs to be carried out within the legal framework thus established. The present supervisory instructions have not touched the area of monitoring unusual and suspicious transaction. There appears a greater need for involvement of regulatory and supervisory processes to make a resilient anti-money laundering regime.

***Recommendation 11***

292. Apart from the recently passed FTRA, there are no existing requirements that financial institutions should pay special attention to all complex, unusual large transactions or unusual pattern of transactions that have no apparent or visible economic or lawful purpose. Neither the CBSL nor any other regulator has issued any instruction or

guidelines to the financial institution that they should pay special attention to such transactions.

293. In terms of the Exchange Control Act, 'Authorised Dealers' are required to make reports about sales and purchase transactions in respect of foreign exchange. On the basis of the reports, the CBSL monitors the pattern of foreign currency sales and purchases of value over US$5000, to detect any unusual fund transfer which may be associated with an unauthorised capital account transaction or suspicious activity. With regard to transactions of large amounts of foreign exchange, operating instruction Ref No EC/06/94 was issued on 18 March 1994 under which authorised dealers have been instructed to inform the Controller of Exchange all transactions exceeding US$20,000 per transaction.

294. Operating Instruction Ref. No.06/08/06/2005, dated 23 September 2005, has been issued directing authorised dealers to monitor accounts used by Electronic Funds Transfer Card Holders for making payments in foreign exchange and to exercise due diligence to prevent the unauthorised transactions. By this operating instruction, authorised dealers have also been directed to report suspicious transactions on credit cards and to take immediate action to suspend that foreign exchange payment. In addition, authorised dealers have been directed to report all the information on credit card holders who have incurred expenditure in foreign exchange exceeding US$5,000 or its equivalent in any other foreign currency, in any one month and who have incurred expenditure for a single transaction exceeding US$3,000 to the Exchange Control Department.

295. In order to enforce the UN Security Council Resolution 1373 (2001) in Sri Lanka, the United Nations Regulation No.1 was gazetted in October 2001. CBSL issued operating instructions to all commercial banks, licensed specialized banks, authorised money changers and all persons authorised to engage in money transfer business, directing them to desist from opening accounts (in the case of banks) or engaging in any other transactions with persons and entities designated for the purpose of the above Regulation or their associates and to report details of the accounts already held if any by such persons and entities or their associates. The list of designated persons and entities which was forwarded to the financial institutions concerned constituted the persons and entities designated by the UN Security Council as persons and entities involved in terrorism and the LTTE. Subsequently the list of designated persons and entities was updated from time to time in terms of the lists circulated by UN Counter terrorism authority, though the list is not completely up to date as noted above.

296. No explicit requirement has been made in the FTRA that financial institutions should examine the background and purpose of complex or unusual transactions or to set forth their findings in writing. However it may be noted that Section 7(2)(c) of the FTRA requires that the STR shall contain a statement of the grounds on which the financial institution holds a suspicion before making an STR.

***Recommendation 21***

297. The FTRA does not require financial institutions to give special attention to business relationships and transactions with persons (including legal persons and other financial institutions) from or in countries which do not or insufficiently apply the FATF Recommendations. No such instructions have been issued by any regulatory authority.

298. Similarly, the FTRA does not provide that there should be effective measures in place to ensure that financial institutions are advised of concerns about weaknesses in

the AML/CFT systems of other countries. No such advice has been issued in this respect by any regulator.

299. No instructions have been issued to require that, for transactions which have no apparent economic or visible lawful purpose, the background and purpose of such transactions should, as far as possible, be examined, and written findings should be available to assist competent authorities. The FTRA also has not provided for such instructions.

300. In relation to the application of appropriate counter-measure for countries that do not or insufficiently apply the FATF Recommendations, the Sri Lankan authorities advised that the Exchange Control Department has taken every initiative to require the banks to be cautious in entering into transactions of large volumes of foreign exchange. However, no existing instructions were quoted in this respect, nor does the FTRA provided for the application of counter-measures. As noted above, with regard to transactions of large amounts of foreign exchange, operating instruction Ref No EC/06/94 was issued on 18 March 1994 under which authorised dealers have been instructed to inform the Controller of Exchange all transactions exceeding US$20,000 per transaction.

### 3.6.2 RECOMMENDATIONS AND COMMENTS

301. There is a need to speedily establish a regulatory and supervisory regime whether exclusively by the FIU or separately by individual regulators and supervisors to issue guidance notes and advisories to the financial institutions. Depending upon the need to ensure uniformity across the entire breadth of financial sector and the special skills or requirements needed in each of the sectors, a 'hybrid' regime may also be considered where the broad framework is established by the FIU and the finer details are filled in by the individual supervisors consistent with the overall risk management approach.

302. It is also recommended that the authorities:

- Implement measures to require financial institutions to examine the background to transactions that are complex, unusual or have no apparent economic or lawful purpose, and to retain a written record of the examination in line with the underlying transaction record.
- Issue guidance to financial institutions to provide practical assistance with monitoring transactions that are complex, unusual or have no apparent economic or lawful purpose.
- Provide that financial institutions should pay special attention in relation to transactions and relationships that involve persons from or in countries that do not adequately apply the FATF Recommendations.
- Introduce a mechanism to alert financial institutions to those countries that are considered not to apply the FATF Recommendations adequately.
- Introduce an inter-agency procedure for determining whether specific counter-measures should be taken, in particular circumstances, against countries that do not adequately apply the FATF Recommendations.

3.6.3 COMPLIANCE WITH RECOMMENDATIONS 11 & 21

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.11** | **Non-compliant** | • **There are no obligations on financial institutions to monitor and keep a record of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.** |
| **R.21** | **Non-compliant** | • **There are no instructions, guidance notes or advisories to the financial institutions in respect of dealings with countries which do not apply or insufficiently apply the FATF Recommendations.** |

## 3.7 SUSPICIOUS TRANSACTION REPORTS AND OTHER REPORTING (R.13-14, 19, 25 & SR.IV)

3.7.1 DESCRIPTION AND ANALYSIS

***Recommendation 13***

303. Section 7 of the FTRA requires that where a financial institution has reasonable grounds to suspect that any transaction or attempted transaction may be related to the commission of any unlawful activity or any other criminal offence, it shall report within two days of forming such suspicion to the FIU. There is no threshold for STRs. The same procedure should be adopted if the financial institution has information that it suspects may be relevant to an act preparatory to an offence under the provision of the Convention on the Suppression of Financing of Terrorism Act or to an investigation or prosecution of a person for an act constituting an unlawful activity or may otherwise be of assistance in the enforcement of the Money Laundering Act. Such reports are required to be writing and maybe given by way of mail, telephone or to be followed up in writing within twenty-four hours, fax or electronic mail or such other manner and be in such form and contain such details as may be determined by the FIU.

304. In terms of the Exchange Control Act, 'Authorised Dealers' are required to make reports about sales and purchase transactions in respect of foreign exchange. On the basis of the reports, the CBSL monitors the pattern of foreign currency sales and purchases of value over US$5000, to detect any unusual fund transfer which may be associated with an unauthorised capital account transaction or suspicious activity. Discussions with the officials of CBSL and its regulated entities did no reveal any other suspicious transaction report being made to CBSL or any other authority.

305. In terms of the FTRA, suspicious transactions are required to be reported in respect of unlawful activity or any other criminal offence. As noted above, the definition of unlawful activity does not include all the categories of offences designated by the FATF, nor does it include tax offences.

306. Because the FTRA has only been passed very recently and no STRs had been made at the time of the on-site visit, it is not possible to assess the effectiveness of the reporting provisions in practice.

Additional elements

307. In terms of Section 7 of the FTRA, institutions are required to report to FIU if they have information they suspect may be relevant to an investigation or prosecution of a

person for an act constituting an unlawful activity, or may otherwise be of assistance in the enforcement of the PMLA.

308. With regard to transactions of large amounts of foreign exchange, operating instruction Ref No EC/06/94 were issued on 18 March 1994 under which authorised dealers have been instructed to inform the Controller of Exchange all transactions exceeding US$20,000 per transaction.

309. Under the Gazette notification issued on 20 May 2005, advance payments can be paid for the importation of goods, where the total value of any goods does not exceed US$10,000 or its equivalent in other convertible foreign currencies. The authorised dealers have been instructed to forward the relevant Exchange Control form in respect of imports duly completed by the applicant together with a copy of the Pro forma Invoice or other documentary proof of value to the Controller of Exchange.

310. Further, operating instructions dated 12 November 2001 have been issued informing the authorised dealers and the specialised banks of the decisions taken to enforce the UN Security Council Resolution No 1 of 2001 on transactions related to terrorism and subversive activities, in Sri Lanka. The list of the names of the persons and the entities that were designated as the persons to whom the regulations should be applied were also conveyed to the authorised dealers and they were instructed regarding the measures should be taken in connection with the transactions carried out by such persons and entities. Several reminders have been issued and authorised dealers have been instructed to diligently comply with the said operating instruction and to report the suspicious transactions if any to the Controller of Exchange.

***Special Recommendation IV***

311. The requirement to report suspicious transactions under section 7 of the FTRA extends to an act preparatory to an offence under the provisions of the Convention on the Suppression of Financing of Terrorism Act or to an investigation or prosecution of a person for an act constituting an unlawful activity or may otherwise be of assistance in the enforcement of the PMLA.

312. It should be noted that 'unlawful activity' includes any act which constitutes an offence under any law or regulation for the time being in force relating to the prevention and suppression of terrorism.

***Recommendation 14***

313. Under section 12 of the FTRA, no civil criminal or disciplinary proceedings shall lie against a director, partner, an officer, employee or agent acting in the course of that person's employment or agency in relation to any action carried out in terms of the Act in good faith or in compliance with regulations made under the Act or rules or directions given by the FIU in terms of the Act. Similar protection is available to the institution itself, its auditor and the supervisory authority of the institution.

314. Under section 9 of the FTRA, a person shall not disclose to any other person that a report has been made or information provided to the FIU in terms of any provision of the Act; that any suspicion in relation to a transaction has been formed or any other information from which it could be reasonably expected to infer that a suspicion has been formed or a report has been made or may be made. Exception has been made in respect of disclosure made for the purpose of duty, for obtaining legal advice or to a supervisory authority.

Additional elements

315. Section 10 of the FTRA provides that a person shall not disclose any information that will identify or is likely to identify the person who has handled a transaction in respect of which a suspicious transaction report has been made; the person who has prepared such report; the person who has reported such a suspicious transaction or the information contained in the suspicious transaction report. Exception has been made in respect of disclosure in respect of investigation or prosecution under the PMLA or the Convention on the Suppression of Terrorist Financing Act, 2005

***Recommendation 25***

316. Section 15(k) of the FTRA provides that the FIU shall periodically report to all Institutions and other relevant agencies regarding the outcome from reports or information given under the Act. Given the recent passage of the FTRA and the fact that FIU is yet to become operational, no such reports have yet been issued.

***Recommendation 19***

317. Section 6 of the FTRA provides that an Institution shall report to the FIU any transaction of an amount in cash exceeding such sum as shall be prescribed by order published in the Gazette or its equivalent in any foreign currency unless the recipient and the sender is a bank licensed by the CBSL. As noted in paragraph 201 above, on 23 March 2006, after the on-site visit, the President of Sri Lanka issued a Regulation (the Financial Transactions Reporting Regulations No. 1 of 2006) and an Order for the purposes of the section 6 of the FTRA, which requires Institutions to reports cash and electronic funds transfers (EFTs) to the FIU. The Regulation and Order set the threshold for reporting both cash transactions and EFTs at 500,000 rupees (approximately US$5000), or its equivalent in any foreign currency.

Additional elements

318. The FTRA has only recently been passed and the gazette notification prescribing the threshold beyond which an Institution must make a large currency transaction report to the FIU was only promulgated after the on-site visit. At the time of the evaluation, therefore, no computerised database available to competent authorities for AML/CFT purposes had been established.

319. However, in terms of the Exchange Control Act, all sales and purchases of foreign currency are required to be reported to the Department of Exchange Control by banks authorised to deal in foreign currency. Travel agents authorised to issue travellers cheques (TCs) are also required to report all such issues of TCs. These reports (except in the case of purchase of foreign currency less than US$5000) have to be made on standard format designed by the Exchange Control Department. With respect to the sale of foreign currency by a bank or travel agent to a resident individual, the information has to be reported in Form I. All foreign exchange sales of value equivalent to US$ 5000 or more have to be reported daily, while sale transactions involving a value of less than US$ 5000 have to be reported weekly. With respect to purchase of foreign currency over the value of US$5000, information has to be provided in Form 2. Purchase of foreign currency of value less than US$5000 can be reported in a consolidated form. Sri Lanka indicated that as a condition for the issuance of a permit to money changers, money changers who are authorised to purchase foreign currency against rupees are also required to report transactions done through them on a monthly basis. The details of the monthly statements are recorded in a computerised database maintained by the

Exchange Control Department and monthly reports are also prepared based on such details.

320. Systems for reporting large currency transactions are not currently subject to strict safeguards to ensure proper use of the information or data that is reported or recorded.

**Recommendation 32: statistics**

321. No statistics are yet available.

3.7.2 RECOMMENDATIONS AND COMMENTS

322. The legal framework exists giving institutions a direct mandatory obligation to make STRS to the FIU. Suspicious transaction reporting under section 7 of the FTRA relates to the predicate offences mentioned in the PMLA, including terrorist financing, as well as any other criminal offence, but does not cover tax offences (which are not criminal offences in Sri Lanka). The FTRA requires all suspicious transactions including attempted transactions to be reported. The FTRA also provides for protection of the employee/director of an institution who is making the STR and ensures the confidentiality of employee making the report. The FTRA also provides for feedback to be made by the FIU to the reporting institutions.

323. The provisions of the FTRA are thus generally sound. However, the FIU is yet to be established and reporting has not commenced. The effectiveness of reporting system is therefore yet to be established, as is the regularity and the quality of reporting.

324. In this connection, the following recommendations are made

- reporting formats for making STRs and cash transaction reports should be prepared and distributed to reporting institutions as soon as possible;
- Competent authorities should establish guidelines that will assist financial institutions and DNFBP to implement and comply with their CFT requirements to report suspicious transactions.
- comprehensive statistics in respect of STRs and cash transaction reports should be maintained in digital form.

3.7.3 COMPLIANCE WITH RECOMMENDATIONS 13, 14, 19 AND 25 (CRITERION 25.2), AND SPECIAL RECOMMENDATION IV

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.13** | **Non-compliant** | • **Though the FTRA provides for suspicious transaction reporting, in practice the system is yet to be established including setting up of an FIU.** |
| **R.14** | **Compliant** | • **The FTRA has made provision for the necessary legal protection of employees/directors and for protecting the identity of the person making reports. The offence of 'tipping off' has also been included in the law.** |
| **R.19** | **Compliant** | • **The intention to create a system of cash transaction reporting is evident, as the FTRA makes specific provision in this respect.** |
| **R.25** | **Non-compliant** | • **Guidelines have not yet been issued to financial** |

| | | |
|---|---|---|
| | | **institutions to assist compliance with AML/CFT requirements.**<br>• **As the FIU is yet to be established and reporting of STRs is yet to commence, the efficacy of feedback systems cannot yet be judged.** |
| **SR.IV** | **Non-compliant** | • **FIU is yet to be established.** |

***Internal controls and other measures***

## 3.8 INTERNAL CONTROLS, COMPLIANCE, AUDIT AND FOREIGN BRANCHES (R.15 & 22)

### 3.8.1 DESCRIPTION AND ANALYSIS

***Recommendation 15***

325. As previously noted, the CBSL issued in 2001 Guidelines on Customer Due Diligence. These guidelines are recommendatory in nature and state that the internal controller/auditor may be required to ensure compliance with the bank's policies on customer acceptance and identification. Discussions with the regulatory authorities did not reveal any other instructions that would require financial institutions to establish and maintain internal procedures, policies and controls to prevent ML and FT, and to communicate these to their employees.

326. Section 14 of the FTRA provides that every institution shall be required to establish and maintain procedures and systems to implement the customer identification requirements; implement procedures for the record keeping and retention requirements; implement process of monitoring and implement the reporting requirements.

327. Section 14 of the FTRA also provides that every institution shall be required to appoint a compliance officer who shall be responsible for ensuring the institution's compliance with the requirements of the Act. However, no specific provision has been made to ensure that AML/CFT compliance officers and other appropriate staff will have timely access to customer identification data and other CDD information, transaction records, and other relevant information. The FTRA does not specify that compliance officers must be at the management level, however it is understood that the Sri Lankan authorities intend to specify this requirement in guidance.

328. Section 14(1)(c) of the FTRA requires every institution to establish an audit function to test its procedures and systems for compliance with the provisions of the Act. However no specific instructions have been issued by any of the supervisors in relation to this requirement.

329. Section 14 of the FTRA provides that every institution shall be required to make its officers and employees aware of the laws relating to money laundering and financing of terrorism and to train its officers, employees and agents to recognize suspicious transactions. Section 14 also provides that every institution shall be required to screen all persons before hiring them as employees.

<u>Additional elements</u>

330. Discussions with some of the domestic banks indicated that the compliance officers responsible for AML/CFT functions typically have access to the bank Board and

the Audit Committee of the Board, in some cases through the CEO rather than direct to the Board. In one foreign bank, the local compliance officer reports to the global compliance structure.

***Recommendation 22***

331. Section 14(3) of the FTRA provides that an institution shall ensure that its foreign branches and subsidiaries adopt and observe measure consistent with the Act to the extent that local laws and regulations permit and, where the foreign branch or subsidiary is unable to adopt and observe such measures, to report the matter to the relevant supervisory authority or, in the absence of a supervisory authority, to the FIU. However, no specific instructions exist to require financial institutions to pay particular attention that this principle is observed with respect to their branches and subsidiaries in countries which do not or insufficiently apply the FATF Recommendations. Similarly, no specific instructions exist to require branches and subsidiaries in host countries to apply the higher standard, to the extent that local (i.e. host country) laws and regulations permit, where the minimum AML/CFT requirements of the home and host countries differ.

332. Section 14(3) of the FTRA provides that an institution shall ensure that its foreign branches and subsidiaries adopt and observe measure consistent with the Act to the extent that local laws and regulations permit, and where the foreign branch or subsidiary is unable to adopt and observe such measures, to report the matter to the relevant supervisory authority or in the absence of a supervisory authority to the FIU.

### 3.8.2 RECOMMENDATIONS AND COMMENTS

333. The FTRA has provided that financial institutions are required to establish sufficient internal control procedures for complying with the AML/CFT requirements, including and independent compliance officer, independent audit functions, proper employee training and appropriate hiring procedures. The banks and non-banks appear to be well regulated from a prudential angle and internal control procedures exist for credit risk etc. However, attention needs to be given by the regulators that internal control measures have a specific focus on AML/CFT issues. This should be done by the issuing of specific directions by financial sector regulators in respect of internal control procedures, independence of the compliance officer responsible for AML/CFT, training and appropriate hiring procedures.

334. Among financial institutions in Sri Lanka, only two local banks have a total of four foreign branches (in the United Kingdom, India, Bangladesh and the Maldives). Therefore, the foreign presence of local banks is extremely limited. The FTRA has clearly defined the scope of home and host country relations in connection with the AML/CFT requirements. Care needs to be exercised that respective supervisors establish systems that would ensure that the financial institutions having foreign presence scrupulously follow the provisions of the law.

### 3.8.3 COMPLIANCE WITH RECOMMENDATIONS 15 & 22

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.15** | **Partially Compliant** | • **The new FTRA law has provided for the requirements but the efficacy can be assessed only after the financial sector supervisors ensure that financial institutions integrate the AML/CFT requirements in their internal control procedures.** |

| R.22 | Largely Compliant | • **The home/host country standard issues have been clearly covered in the FTRA. However the provisions are yet to be tested in live situations.** |
|---|---|---|

## 3.9 SHELL BANKS (R.18)

### 3.9.1 DESCRIPTION AND ANALYSIS

335. While there are no express legislative provisions prohibiting shell banks in Sri Lanka, the bank licensing process effectively precludes the establishment and operation of shell banks in the country. Under sections 2 and 76a of the Banking Act, institutions must obtain a license issued by the Monetary Board of the CBSL to carry on a banking business in Sri Lanka. The legislation sets out specific criteria to be met by all applicants that wish to operate a licensed commercial bank or a licensed specialized bank.

336. Banks applying for a license must provide information on the location of their activities, and must obtain an authorisation to open or close a branch, agency or office. The Banking Supervision Department of the CBSL, as part of its supervisory activities, conducts on site examinations. In its role of issuer of license and supervisor, the CBSL does not allow the establishment or accept the continued operation of banks with no physical presence. All licensed commercial banks and licensed specialised banks in Sri Lanka have a physical presence in the country.

337. The Controller of Exchange issued, in December 2001, a circular to all commercial banks in respect of correspondent relationships with shell banks. The circular refers to guidance issued by the Department of Treasury of the United States, and notes that Commercial Banks should not maintain accounts for shell banks without the prior approval of the Controller of Exchange.

338. In general, instructions issued by the Controller of Exchange are binding as they involve transactions between the resident and a non-resident upon which the Controller of Exchange could impose restrictions. Under section 51 of the Exchange Control Act, the failure to comply with a direction issued by Controller of Exchange constitutes an offence under the Act. That said, representatives of financial institutions met by the Evaluation Team were not aware of this circular, which indicates that the implementation of this provision may not be effective. Furthermore, it states that correspondent relationships with shell banks can be allowed by the Controller of Exchange. Finally, the circular does not include provisions requiring financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

### 3.9.2 RECOMMENDATIONS AND COMMENTS

339. Sri Lanka should ensure that the enforceable prohibition on financial institutions from entering into, or continuing, correspondent banking relationships with shell banks is fully enforced. Sri Lanka should introduce an enforceable obligation for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

### 3.9.3 COMPLIANCE WITH RECOMMENDATION 18

| | Rating | Summary of factors underlying rating |
|---|---|---|
| R.18 | Partially | • **The bank licensing process effectively precludes the** |

|  | Compliant | establishment and operation of shell banks.<br>• The prohibition on correspondent banking relationships with shell banks does not appear to be enforced.<br>• There is no requirement for banks to establish that their respondent banks are not undertaking business with shell banks. |
|---|---|---|

### ***Regulation, supervision, monitoring and sanctions***

## 3.10 THE SUPERVISORY AND OVERSIGHT SYSTEM - COMPETENT AUTHORITIES AND SROS ROLE, FUNCTIONS, DUTIES AND POWERS (INCLUDING SANCTIONS) (R.23, 30, 29, 17, 32 & 25)

### 3.10.1 DESCRIPTION AND ANALYSIS

**Overview**

340. There are three primary financial services regulators in Sri Lanka: the CBSL (which has various departments responsible for the regulation and supervision of various types of financial institutions), the Securities and Exchange Commission of Sri Lanka and the Insurance Board of Sri Lanka.

*Central Bank of Sri Lanka*

341. The CBSL regulates and supervises the Licensed Commercial Banks, Licensed Specialized Banks and Non-Banking financial institutions. It has been stated in the Financial Stability Review, 2005 that the CBSL performs its regulatory and supervisory functions with a view to ensuring the safety and soundness of banks and banking system and safeguarding the interests of depositors and therefore, focuses on encouraging and promoting efficient risk management of banks. This function, governed mainly by the Banking Act and the Monetary Law Act, is carried out through the issue of directions under the statutes, issue of prudential requirements and guidelines, granting approval for licensing, establishing and closing of banks, branches and other business outlet of banks, off-site examinations of banks, enforcement of regulatory actions and resolution of weak bank in terms of statutes. The Sri Lankan authorities also stated that regulation and supervision is carried out as far as possible through the application of international best practices and in compliance with the Basel Core Principles. Directions and prudential requirements mainly relate to the control and mitigation of many risks such as those relating to capital, liquidity, large exposures, open positions, share ownership in banks, investment in shares by banks, income recognition and provisioning for bad and doubtful debts, related party transactions, acquisition of immovable property, disclosure of quarterly and annual financial statements, preparation of annual accounts and the audit of banks, corporate governance and adherence to know-your-customer rules.

342. In terms of the provisions of the Monetary Law Act, all Licensed Commercial Banks are subject to on-site examinations, at least once during each examination period as determined by the Monetary Board, which at present is two years. CBSL has adopted a risk-based examination process which focuses on identification of banking risks (such as credit risk, liquidity risk, market risk, concentration risk and operational risk), the management of these risks and adequacy of resources to mitigate these to a manageable

level. In addition, banks' compliance with prudential requirements, applicable laws and regulations, internal controls and the standards of corporate governance is assessed.

343. Further, the Financial Stability Review observes that the non-availability of regulatory authority to conduct the 'fit and proper test for bank owners and managers is a considerable vacuum in resolving banking problems and this will be brought within the regulatory framework'. This was done by a 2005 amendment to the Banking Act. It was also observed that in the absence of money laundering legislation, the CBSL has issued 'Know Your Customer' (KYC) Guidelines to all banks to ensure that banks prevent the abuse and misuse of their payment schemes by money launderers.

344. The Department of Supervision of Non-Bank Financial Institutions (DSNBFI) of the CBSL has been entrusted with regulation and supervision of finance companies in terms of the Finance Companies Act, 1988. The Act contains, primarily, the provision for the registration of finance companies, regulations and supervision. These include he legal status, capital requirements, and the powers of the Monetary Board of the CBSL to issue directions with regard to the conduct of business. The Act has a special provision requiring every finance company to conduct its business in a manner that safeguards the interest of depositors. In terms of the Act, a number of directions have been issued by the Monetary Board on capital adequacy, lending, investments, deposits, transactions with related parties, single borrower limit, and preparation and presentation of financial information for public awareness. DSNBFI follows off-site and on-site supervision practices. Off-site supervision is carried out based on the information submitted by finance companies on weekly, monthly, quarterly and annual basis. At on-site examination, the accuracy of returns submitted and the books and accounts are examined to ensure that the directions are complied with and systems and controls are properly followed. The objective of an on-site examination of a finance company is to evaluate the overall condition of such company in terms of CAMEL approach plus adequacy of systems and controls, internal audit and compliance with Directions and Rules issued by the Monetary Board. A spot examination is also conducted on an annual basis on every finance company before its license is renewed. At spot examinations, the accuracy of returns submitted and the books and accounts are examined to ensure that the directions are complied with and whether proper systems and controls are in place. Further, DSNBFI is also empowered to supervise the finance leasing establishments registered with CBSL under the Finance Leasing Act, 2000. The supervision of these is expected to be commencing shortly.

345. The Finance Companies Act also requires all registered finance companies to publish the financial statements within 6 months after the close of a financial year. In addition, under a rule issued by the Monetary Board, registered finance companies are required to publish certain financial information in the advertisements issued for soliciting deposits.

*Securities and Exchange Commission*

346. The Securities and Exchange Commission of Sri Lanka (SEC) was established by the Securities and Exchange Commission of Sri Lanka Act, 1987 for the purpose of regulating the securities market of Sri Lanka; to grant licences to stock exchanges, managing companies in respect of each unit trust, stock brokers and stock dealers who engage in the business of trading in securities; to register market intermediaries etc. The terms and conditions to be complied with for the purpose of granting registration as a market intermediary include the requirement of not having been declared as bankrupt, not having been directors of a company whose registration was cancelled by the SEC, and having good financial standing and directors possessing adequate qualifications and training as determined by the SEC. A Deputy Governor of CBSL is, by provision of law, a

member of the SEC. The protection of interests of Investors is one of the main objectives of the SEC. The SEC has powers to give general or specific directions to stock exchanges, stockbrokers, managing companies, trustees of unit trust or a market intermediary from time to time. The SEC also has powers to carry out inspection of the activities of the above entities and to require them to submit audited balance sheets. Finally, the SEC has powers to cancel the licences issued to the above entities. The SEC is funded through a CESS Levy in Terms of Section 14A(1) of the SEC Act and fees paid to obtain registration / licensing. These monies are used by the SEC in Terms of Section 14B(1) to carry out its functions. No monies are received from Parliament.

*Insurance Board of Sri Lanka*

347. Insurance Board of Sri Lanka: The insurance industry is regulated and supervised in terms of the Regulation of Insurance Industry Act of 2000 under which Insurance Board of Sri Lanka (IBSL) was established. The mandate of the IBSL is to ensure that insurance business in Sri Lanka is carried out with integrity and in a professional and prudent manner with a view to safeguarding the interests of the policy-holders. The IBSL is responsible for the licensing of insurance companies and insurance brokers.

348. The Supervision Division of the IBSL monitors the financial and operational performance of all insurance companies and insurance broking companies; ensures that insurance and insurance broking companies maintain financial stability; employ competent staff to conduct business; conducts on-site routine inspections; conducts off-site inspections based on quarterly returns, annual returns and audited accounts and also insures that there is fairness and level playing field in the insurance market. Although the Regulation of Insurance Industry Act provides for funding from the Parliament, the IBSL manages all its Capital and revenue expenditure without any dependence from the Consolidated Fund. Further in addition to registration and Annual Fees received from insurers the Board also receives registration and renewal fees from brokers.

***Recommendation 23***

349. The Sri Lankan authorities stated in their mutual evaluation questionnaire response that once the PMLA and the FTRA are enacted, the FIU would ensure that there is adequate supervision relating to AML/CFT and that the financial institutions in Sri Lanka comply with the directions to effectively implement the FATF recommendations.

350. The Sri Lankan authorities also stated that the Government of Sri Lanka is committed to ensure that FIU will be established to ensure that financial institutions adequately comply with the requirements to combat money laundering and terrorist financing.

351. As previously noted, the FIU is yet to become operational in Sri Lanka, so it was not possible to assess the effectiveness of its AML/CFT supervision and compliance functions.

*Market entry*

352. In terms of the Banking Act, 1988, banks are subject to licensing procedures under which the Monetary Board of the CBSL issues licences. The Banking Act has laid down the “fit and proper’ criteria for Directors and shareholders holding over ten per cent of the issued capital of commercial banks. An amendment to the Act in 2005 has provided for the ‘fit and proper’ requirements in relation to directors of banks. Section 42 of the Banking Act, 1988 provides all Directors of Bank to comply with the “fit and proper”

criteria set out therein. There are no requirements of fitness and propriety on other financial sector companies and intermediaries.

353. Security market intermediaries are also subjected to licensing by SEC.

354. No insurance company either for long term insurance business or general insurance or both shall carry on insurance business in Sri Lanka unless it is registered by the IBSL. An application is to be made giving business plan for a period of three years. The IBSL has power to suspend or cancel the license if it fails to meet several criteria including failure to maintain the solvency margin or contravention of any provision of the Regulation of Insurance Industry Act, 2000. The IBSL also has the power to register insurance brokers and to suspend, cancel or refuse to renew certificate issued to a broker.

355. Under section 57 of the Regulation of Insurance Industry Act, the Insurance Board is allowed, when it deems it necessary, to instruct an insurer to take specific action, including recruiting, to ensure that its management personnel take measure resulting in the company operating in accordance with sound insurance principles. This power includes the ability to remove any director that the Board considers unfit.

356. Sri Lankan authorities stated in their mutual evaluation questionnaire response that the provisions of the Exchange Control Act necessitate obtaining a license to undertake such services. Under section 5(1) of the Exchange Control Act, money changers have been appointed as restricted dealers in foreign exchange. The permission to engage in money changing business is granted subjected to several terms and conditions. For example, money changers are not allowed to sell foreign currency and they are authorised only to purchase and to exchange foreign currency. In terms of the conditions of the permit issued to money changers, they are supposed to furnish the monthly statements of the transactions to the Exchange Control Department.

357. These monthly statements are recorded in the database maintained by the Exchange Control Department and are monitored by the Investigation Unit of the Exchange Control Department. Suspicious cases arisen from such statements are further investigated. In addition, an examination guideline based on the AML/CFT recommendations has been prepared and on-site supervisions into the activities of the money changers are conducted in order to examine whether they do engage in the money changing business in compliance with the terms and conditions of the permit. The Sri Lankan authorities indicated that the terms and conditions of the permit issued to the moneychangers cover AML/CFT requirements. For example, money changers are required to obtain the details of the customers (i.e. name, Id. No., passport number) and to record such details in a separate register apart from the receipt issued to the customer.

358. Moreover, the money changers come under the category of ''finance business'' in terms of the Prevention of Money Laundering Act (PMLA) and they are supposed to adhere the measures that have been stipulated in the PMLA. In terms of the FTRA, money changers are also required to report suspicious transactions to the FIU. Once the FIU is established, measures will be taken to make aware the money changers regarding such legislative requirements.

359. All institutions which accept deposits from public other than licensed commercial banks and licensed specialised banks are required to obtain a license to undertake "Finance Business" as defined in the Finance Companies Act No.78 of 1988 from the Monetary Board. The Department of Supervision of Non-bank Financial Institutions supervises the activities of Finance Companies and Leasing Companies. Further, these

institutions are also subject to the provisions of Financial Transactions Reporting Act, 2006.

*Ongoing supervision and monitoring*

360. Banks are subject to both on-site and off-site surveillance. Under the off-site surveillance system, the CBSL monitors the financial conditions of banks on the basis of periodic information provided by the banks on their operations. Such information includes weekly interest rates of deposits and advances, monthly returns and selected financial information, liquid assets, capital adequacy, non-performing advances etc. The information gathered is analysed to ascertain the risk exposure in both a micro perspective and macro perspective and serves as an early warning system triggering prompt corrective action. Visits to various banks confirmed that the detailed onsite inspections are undertaken once every two years.

361. The SEC has established a committee to receive and investigate complaints from the public relating to the professional conduct or activities of licensed stock brokers and stock dealers, managing companies, trustees of units trusts and registered market intermediaries. Licensed or registered persons or entities are required to file audited annual income statements and balance sheets. The SEC has the authority to require any information and document as necessary to assess compliance with the legislation as well as carry on on-site inspections. The SEC conducts an annual visit at each registered or licensed intermediary. At present approximately 20 on-site inspections and 45 off-site inspections are carried out annually.

362. Insurance companies and insurance brokers are required to obtain a license from the IBSL. Every insurance company or broker is must keep a register of all their insurance agents, and provide the IBSL with a copy of the register on an annual basis. The IBSL has powers to investigate the affairs of an insurer. Where the IBSL is satisfied that the affairs of any insurer are being conducted in a manner likely to be detrimental to the public or national interest or the interest of the policy holders or prejudicial to the interest of the insured, the Board may issue such direction to the insurer as it may consider necessary including removal of directors or any other person. IBSL carried out inspection of 12 Insurance Companies and five Insurance Broking Companies during 2004.

363. Sri Lankan authorities advised that examples of regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, include requirements for: (i) licensing and structure; (ii) risk management processes to identify, measure, monitor and control material risks; (iii) ongoing supervision and (iv) global consolidated supervision where required by the Core Principles. The relevant statutes viz. The Banking Act, 1988 vests the CBSL with general supervisory powers which have some application to AML/CFT and were the basis for the KYC Guidelines, but the Sri Lankan authorities indicated that adequate powers with regard to AML/CFT financing were provided in the newly enacted PMLA and FTRA.

364. In relation to money/value transfer services, foreign exchange business is subject to control by the Exchange Control Act and required permits by the CBSL. Only authorised commercial banks and dealers (e.g. money changers) are allowed foreign exchange businesses. Receipt of overseas remittance is also subject to the Exchange Control Act.

365. In relation to other financial institutions, all institutions which accept deposits from public other than licensed commercial banks and licensed specialised banks are required to obtain a license to undertake “Finance Business” as defined in the Finance

Companies Act, 1988 from the Monetary Board. The Department of Supervision of Non-bank Financial Institutions supervises the activities of Finance Companies and Leasing Companies.

366. Stock brokers, stock dealers and managing companies for unit trusts must obtain a license from the Securities and Exchange Commission of Sri Lanka. Market intermediaries must be registered.

***Recommendation 30***

367. The Sri Lankan authorities indicated that the FIU, once established, will be staffed by qualified professionals in the fields of law, forensic accounting, management and supervision of banks and other finance institutions. It is expected that international agencies would assist Sri Lanka to ensure the establishment of a modern FIU with well trained officials who would be adequately trained to discharge the functions expected of them under the FTRA.

368. Banks and Non-Banks are supervised by the CBSL and the relevant departments of the CBSL have sufficient resources and staff to carry on their functions. The directors of the concerned departments have powers and duties that have been enshrined in the Banking Act and the Finance Companies Act of 1988.

369. The SEC consists of the Deputy Secretary to the Treasury, the Registrar of Companies, the President of the Institute of Chartered Accountants, Deputy Governor of the CBSL and six other members appointed by the Minister of Finance and Planning. The SEC is funded through a cess levy under Section 14A(1) of the SEC Act and fees paid to obtain registration / licensing. The SEC has 45 staff members and appeared to be adequately resourced to carry out is functions, but does not consider itself adequately staffed or resourced and is considering a substantive increase of its staff.

370. The IBSL is constituted of the Deputy Secretary to the Treasury, a Deputy Governor of the CBSL, the Director General of the SEC and four members appointed by the Minister of Finance and Planning. It receives funding voted by Parliament as well as registration and annual fees from insurers. The IBSL has 17 staff members, including nine permanent employees

371. It was stated by the CBSL officials that all CBSL employees are required to make a declaration of confidentiality to maintain secrecy of information to which he has access. In terms of Section 45 of Monetary Law Act, all CBSL officers are prevented from disclosing confidential information. Training also emphasizes the importance of maintaining integrity and confidentiality

372. There are no specific provisions in the insurance and securities legislation on employee integrity and confidentiality requirements.

373. Some AML/CFT training has been provided to CBSL staff. Opportunities have been given for 12 officers attached to the Banking Supervision, Legal, and Exchange Control Departments and to the Legal Reforms Project to participate in 17 training programs/seminars/workshops in areas relating to AML/CFT.

***Authorities' Powers and Sanctions – Recommendations 29 & 17***

**Recommendation 29**

374. As described in the overview above, the provisions of the Banking Act and the Finance Companies Act contain adequate powers to ensure compliance by financial institutions. These powers can also be used to issue directions to banks and non-banks to combat money laundering and financing of terrorism. The SEC and the IBSL are also constituted the Securities and Exchange Commission of Sri Lanka Act and the Regulation of Insurance Industry Act respectively and are endowed with supervisory powers.

375. Section 41 of the Banking Act, 1988 has vested powers in the Monetary Board to cause examination of a licensed commercial bank or any of its subsidiaries.

376. Section 12 of the Finance Companies Act, 1988 provides that the Director may, at any time, examine or authorize any officer of his department to examine the books and accounts of any finance company.

377. Section 14 of the Securities and Exchange Commission of Sri Lanka Act, 1987 grants the SEC the power to carry on inspections of the activities of licensed stock brokers and stock dealers, managing companies, trustees of units trusts and registered market intermediaries.

378. Section 54 of the Regulation of Insurance Industry Act, 2000 allows the IBSL to order an investigation into the affairs of an insurance company by an auditor or an actuary.

379. Section 41 of the Banking Act, 1988 provides for production of all books, minutes, accounts j, cash securities, vouches, other documents and records relating to its business at the request of inspecting officer and has provided sanctions if it is not done. Section 12 of the Finance Companies Act, 1988 also provides that the company under examination is required to produce all records, books of accounts etc. Section 45 of the Securities and Exchange Commission of Sri Lanka Act, 1987 allows the SEC to require the production of any information or document that is necessary to perform its function under the Act.

380. In carrying out inspections under section 54 of the Regulation of Insurance Industry Act, 2000, the IBSL can require the production by any party of the books, accounts, records or other documents of an insurer.

381. No specific reference has been made to suspicious transactions. Section 18 of FTRA has given sufficient powers to the FIU to cause production of all details.

382. The provisions of the law do not refer to the necessity of a Court Order to compel production of or to obtain access to information for supervisory purposes.

383. The Banking Companies Act, 1988 and the Finance Companies Act, 1988 have given sufficient powers of enforcement in the hands of the supervisors for running the business of banks and finance businesses on prudent lines. No specific reference to AML/CFT has been made. The specific power in respect of enforcement of AML/CFT has been vested with the FIU.

***Recommendation 17***

384. The provisions of the FTRA provide for effective, proportionate and dissuasive criminal, civil or administrative sanctions to deal with natural or legal persons covered by the FATF Recommendations that fail to comply with national AML/CFT requirements.

385. The financial sector regulators do not have specific powers to apply sanctions for breaches of AML/CFT requirements. However, as the regulated entities function under licenses issued by the regulators, they are required to follow the directions issued by the regulators and for non-compliance, the sanctions can extend to withdrawal of licence.

386. In terms of the Banking Act, 1988, where the Monetary Board is satisfied that any licensed commercial bank has contravened any provision of the Act or any direction, order or other requirement imposed under the Act, the Monetary Board may give notice that it would cancel the licence issue to such bank. The Act goes on to stipulate the process that must be undergone for the ultimate cancellation of the licence. Further, where the Director of Bank Supervision is satisfied that a licensed commercial bank is engaged in unsafe and unsound practices or has contravened or failed to comply with the provisions of the Act or of any regulation, direction, order or other requirement made or given under the Act, he can issue an order directing the bank to cease and desist from such practice, to comply with the provisions or to take necessary corrective action. A licensed commercial bank which fails to comply with such order shall be guilty of an offence under the Act and shall be liable on conviction upon trial by a Magistrate to a fine of one million rupees and to further fine of one hundred thousand drupes for each day of non-compliance.

387. Similarly in terms of Finance Companies Act, 1988 the Monetary Board has powers to issue directions to finance companies regarding the manner in which any aspect of the business of the finance company is to be conducted. Further, where the Board is of the opinion that a company is following unsound or improper financial practices or has contravened or failed to comply with any provision of the Act or any direction issued there under, the Board can direct the company to cease and desist from any such contravention or comply with the provisions of the Act. Directors, Chief Executive, employees etc. who fail to comply with any direction issued by the Board shall be guilty of an offence under the Act and shall be liable upon conviction after a trial before a Magistrate's court to imprisonment not exceeding three years or fine not exceeding Rupees One Million.

388. In fulfilling its mandate, the SEC has authority to give general or specific directions to a licensed stock broker or dealer, unit trust managing company or registered market intermediary. The SEC can also suspend or cancel a license or registration when necessary. Failure to comply with any provision of the Securities and Exchange Commission Act constitutes an offence under the Act liable to imprisonment for a maximum of five years or a fine of up to ten million rupees. The penalties differ in the context of insider dealing and related offences and a person who contravenes any provisions in Part IV to the SEC Act is guilty of an offence and shall on conviction be liable to a fine of not less than one million rupees or to imprisonment for a term not less than two years and not exceeding five years or to both such fine and imprisonment.

389. In the insurance sector, where the IBSL believes that the business of an insurer is being conducted in a manner likely to be detrimental to the public or national interest or the interest of the policy holders or prejudicial to the interests of the insurer, the IBSL may issue directions to the insurer as it deems necessary. Failure to comply with directions of the IBSL can result in the suspension or cancellation of a registration or license. The Regulation of Insurance Industry Act, 2000 also provides that insurers companies, insurance brokers and insurance agents that fail to comply with any provision of the Act, including the obligation to be licensed or registered, are guilty of an offence under the Act and are liable to an imprisonment term of at least one year or minimum fine of 50 thousand rupees.

*Recommendation 25 (Guidance for financial institutions other than on STRs)*

390. Supervisory Institutions are yet to issue comprehensive supervisory guidance to the financial and non-financial institutions in respect of AML/CFT. Apart from the non-mandatory guidance note on KYC issued to banks in 2001 by CBSL, there appear to be no other relevant supervisory instructions.

391. IBSL has not issued any AML/CFT procedures or guidelines to insurance companies or insurance broking companies. However an IMF Consultant is reported to be attending to the task. IBSL has plans to develop appropriate onsite and offsite inspection procedures to ensure compliance with AML related legislation and integrate the inspection procedures into the CARAMELS Risk based Supervision Framework. It will also review insurance products sold by Sri Lankan insurers and identify those that may have potential AML implications. The time frame for completion of the above tasks has been given as 30 September 2006.

### 3.10.2 RECOMMENDATIONS AND COMMENTS

392. The basic licensing and supervisory structure for banks, non-banks, securities market intermediaries and insurance companies exists. However, the respective supervisors have yet to integrate AML/CFT issues in their regular supervisory role. There seems to be an underlying belief that the establishment of the FIU will solve all the matters concerning AML/CFT, however when the FIU becomes operational there will need to clearly define the respective responsibilities of the FIU and of the industry regulator and to ensure that the FIU and supervisors work together to ensure effective AML/CFT regulation and supervision. All supervisors should integrate the AML/CFT requirements into their directions, regulations and guidance notes etc. to the supervised institutions.

393. It is also recommended that Sri Lanka should:

- Clarify the role and powers for the regulatory agencies and the FIU to explicitly monitor for compliance with AML/CFT. It would be helpful if clear delineation is made as to the particular agency that would be in charge for monitoring for AML compliance by the relevant covered institutions.
- Establish a comprehensive training programme in AML/CFT issues for each of the regulatory agencies.
- Ensure that supervisory authorities and applicable sanctions apply for non-compliance specifically for AML/CFT purposes in each sector.
- Establish specific AML/CFT obligations and ensure supervisory authorities and appropriate sanctions powers are granted for violations in the insurance sector.
- Establish an AML/CFT supervisory capacity for money service businesses and exchange dealers by including AML/CFT provisions in inspection and auditing processes to encompass all the requirements as set forth by the FATF 40 Recommendations that must be applied to non-bank financial institutions.
- Establish sanctions authorities for non-compliance by money service businesses and exchange dealers.

### 3.10.3 COMPLIANCE WITH RECOMMENDATIONS 23, 30, 29, 17, 32, AND 25

| | Rating | Summary of factors relevant to s.3.10 underlying overall rating |
|---|---|---|

| | | |
|---|---|---|
| **R.17** | **Partially compliant** | • **As the FTRA has only very recently come into force, and the FIU is yet to become operational, there has been no implementation of penalties that are effective and dissuasive for non-compliance specifically with AML/CFT obligations.** |
| **R.23** | **Non-compliant** | • **While the recently passed FTRA and establishment of the FIU will improve the situation, apart from the issuing of the 2001 KYC Guidelines by the CBSL, to date there has been very little focus on AML/CFT regulation and supervision by industry regulators.**<br>• **Oversight of the foreign exchange dealers and money remitters is directed primarily at compliance with Exchange Control Act, and not at AML/CFT issues.**<br>• **Recent amendments in 2005 to the Banking Act provide for the requirement of fitness and propriety for directors and significant shareholders of banks. However, there are no requirements of fitness and propriety on other financial sector companies and intermediaries.** |
| **R.25** | **Non-compliant** | • **Supervisory Institutions are yet to issue comprehensive supervisory guidance to the financial and non-financial institutions in respect of AML/CFT. Apart from the non-mandatory guidance note on KYC issued to banks in 2001 by CBSL, there appear to be no other relevant supervisory instructions.**<br>• **In the absence of an operational STR system, no feedback has been provided to reporting institutions.** |
| **R.29** | **Partially compliant** | • **The newly enacted FTRA and other relevant Acts contain generally adequate powers and sanctions, however there has been a lack of effective implementation in relation to AML/CFT supervision.**<br>• **The respective roles of the FIU, when operational, and existing sectoral regulators in AML/CFT supervision need to be clarified to ensure effective implementation.** |
| **R.30** | **Partially compliant** | • **The FIU is yet to be staffed and operationalised.**<br>• **Supervisors and other competent authorities are generally adequately structured and staffed, but additional training is required on ML/CFT issues.** |
| **R.32** | **Partially compliant** | • **Statistics for this part of the Recommendation are available to a varying extent across agencies.** |

### 3.11 MONEY OR VALUE TRANSFER SERVICES (SR.VI)

#### 3.11.1 DESCRIPTION AND ANALYSIS (SUMMARY)

394. Many Sri Lankan workers go abroad to work, most often in the Middle East, and remit their income back home. Many people among the large community of expatriates established in western countries such as Germany, the United Kingdom and Canada also regularly send money back to their relatives in Sri Lanka. Inbound remittances are therefore a significant source of income for Sri Lanka.

395. Section 7 of the Exchange Control Act prohibits any person in Sri Lanka from transferring funds outside the country, or from paying funds to a resident that is the beneficiary of an inbound funds transfer, except with the permission of the CBSL.

396. Currently, the Authorised Dealers, i.e. commercial banks, are permitted to act as money remitters. Exchange Houses, global money transfer services and companies registered outside Sri Lanka are engaged in channelling funds from locations outside the country through the banking system. At present, only the commercial banks are permitted to operate as disbursing remittance service providers with, one exception. Outward remittances for the authorised purposes are also allowed through commercial banks i.e. authorised dealers. Such Authorised Dealers have been instructed by the CBSL to exercise their due diligence in respect of those outward remittances.

397. Although underground money remittance systems, sometimes known as Hawala, are illegal, they are a thriving sector in Sri Lanka, for a number of reasons. For many residents of Sri Lanka, the absence of nearby bank branches makes it difficult to receive remittances through that channel. Also Sri Lankan workers in countries such as India or the Middle East often do not have easy access to a bank branch to remit their money.

398. In addition, due to cultural factors, relatively low costs, speed and reliability, the use of underground money remittance systems is more widespread when compared with banks, in particular for small transfers. Finally, underground money remitters can be an attractive option for outbound remittances, given the legal restrictions on such transactions. Law enforcement has indicated to the Evaluation Team that it is very difficult to enforce the prohibition on Hawala and investigate illegal money transmitters.

399. Legal money remitters that use banks as agents are not directly regulated or supervised. Legal requirements apply to the banks that act as their agents for them. The definition of finance business under the FTRA includes “the transfer of money or value” and “issuing and managing means of payment”. However, compliance with the FTRA requirements cannot be imposed on money remitters if they are considered to be illegal.[6]

#### 3.11.2 RECOMMENDATIONS AND COMMENTS

400. The absence of a legal money remittance sector has pushed a significant portion of the remittance flows underground, preventing any supervision and monitoring. This makes the money remitters very attractive in particular for the funding or terrorism.

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[6] In order to regulate the payment, clearing and settlement systems, Sri Lanka has recently enacted Payment and Settlement Act No.28 of 2005. Section 11 of that Act requires the CBSL to monitor, supervise and regulate the money remitters. Accordingly, Sri Lanka advises that regulations are being prepared based on the FATF Recommendations to regulate the existing money remitters (other than the commercial banks) i.e. representative for Western Union Money Transfer Service in Sri Lanka.

401. It is recommended that Sri Lanka should:

- Provide for a category of properly licensed and regulated remittance businesses outside of banks to perform money or value transfer services in order to attract remittance from underground 'hawala' into formal supervised remittance channels.
- Require registration and licensing and establish supervision for money remitters that use commercial banks as their agents;
- appropriate monitoring be conducted to ensure compliance of money remitters with the FTRA;
- consider establishing a task force to determine the true scale of alternative remittance, which includes all relevant policy, tax, enforcement, and investigative agencies;
- conduct outreach/education campaigns to help bring illegal remitters into the formal financial structure through licensing.

3.11.3 COMPLIANCE WITH SPECIAL RECOMMENDATION VI

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **SR.VI** | **Non-compliant** | • **There is no licensing or registration requirement for legal non-bank money remitters.**<br>• **Informal money remitters, while prohibited by law, are thriving, but not subject to any AML/CFT provisions or effective sanction.** |

# 4 PREVENTIVE MEASURES – DESIGNATED NON-FINANCIAL BUSINESSES AND PROFESSIONS

## 4.1 CUSTOMER DUE DILIGENCE AND RECORD-KEEPING (R.12) (APPLYING R.5, 6, 8 TO 11, & 17)

### 4.1.1 DESCRIPTION AND ANALYSIS

402. All Designated Non-Financial Businesses and Professions (DNFBPs) covered under FATF Recommendation 12 operate in Sri Lanka, including casinos, real estate firms and agents, gold bullion sellers and other dealers in other precious metals and stones, solicitors and barristers and accountants. Trust and company service providers do not operate as distinct entities from other professionals such as lawyers or accountants. There are currently no legislative or regulatory requirements or guidelines in force applicable to DNFBPs in respect of customer due diligence.

403. DNFBPs are included in the definition of "Institution" in the FTRA. This definition, applies to "designated non-finance business" and includes:

- casinos, gambling houses or conducting of a lottery including a person who carries on such business through the internet when their customers engage in financial transactions equal to or above the prescribed threshold;
- real estate agents, when they are involved in transactions for their clients in relation to the buying and selling or real estate;
- dealers in precious metals and dealers in precious and semi-precious stones, when they engage in cash transactions with a customer equal to or above the prescribed threshold (500,000 rupees).;
- lawyers, notaries other independent legal professionals and accountants when they prepare for or carry out transactions for their clients in relation to any of he following activities:
    - i. buying and selling of real estate;
    - ii. managing of client money, securities or other assets;
    - iii. management of bank, savings or securities accounts;
    - iv. organization of contributions for the creation, operation or management of companies;
    - v. creation, operation or management of legal person or arrangements; and
    - vi. buying and selling of business entities.
- trust or company service providers not otherwise covered by the definition.

*Applying Recommendations 5, 6, 8 and 9*

404. There is no distinction in the application of the customer due diligence provision of the FTRA, to institutions that are engaged in "finance business" and those engaged in "designated non-finance business". The requirements will apply on a business relationship basis or a transaction basis, depending on the activities of the DNFBP. As noted above, a reporting threshold of 500,000 rupees in respect of transactions was prescribed in regulations issued under the FTRA in March 2006.

405. As other institutions, DNFBPs will be required, under the FTRA, to comply with some of the criteria under FATF Recommendation 5 on identity verification and ongoing

due diligence, as well as the record-keeping standards set out in Recommendation 10. The FTRA does not however include requirements consistent with FATF Recommendations 6, 8, 9, or 11.

406. Unlike banks and finance companies, for which the KYC Guideline was issued by the CBSL in December 2001, there seems to be very little awareness within the DNFBP sector of the FTRA and its customer due diligence requirements. The authorities have not conducted consultation and outreach with these sectors in respect of the application of the FTRA.

*Applying Recommendation 10*

407. With respect to record-keeping, the FTRA provisions applicable to financial institutions also apply to DNFBPs. Section 4 of the FTRA requires every institution, including DNFBPs, to maintain records of transactions and of correspondence relating to transactions and records of all reports furnished to the FIU for a period of six years from the date of transaction, correspondence or the furnishing of the report. There are no legislative or regulatory requirements in respect of record-keeping financial for services provided by DNFBPs in other statutes.

*Applying Recommendation 11*

408. As with financial institutions, DNFBPs are not required under the FTRA to pay special attention to all complex, unusual large transactions or unusual pattern of transactions that have no apparent or visible economic or lawful purpose. DNFBPs are not required to examine the background and purpose of such transactions or to set forth their findings in writing.

*Applying Recommendation 17*

409. DNFBPs subject to the FTRA are subject to the same penalties as financial institutions. Section 28 of the FTRA provides for fines or imprisonment for making false or misleading reports to the FIU, unauthorised disclosure that a report has been made, non-cooperation with the FIU, falsification or unauthorised destruction of documents and keeping an account under a fictitious or false name. There is no specific offence for non-reporting or failure to conduct customer due diligence. Sri Lanka has yet to determine which regulatory body will be responsible for monitoring the compliance of DNFBPs with the FTRA and imposing sanctions for non-compliance.

### 4.1.2 RECOMMENDATIONS AND COMMENTS

410. The FTRA covers all DNFBPs and activities listed under Recommendation 12. Aside from the fact that the customer due diligence provision of the FTRA are not yet in force, the same deficiencies as those noted in section 3.2 of this report are applicable to the DNFBP provisions. The unclear legal status of casinos (as discussed under section 4.3 of this report) makes the application of FTRA to that sector doubtful.

411. It is recommended that:

- a money laundering threat assessment be conducted for DNFBP sectors;
- gaps outlined in sections 3.2 and 3.6 of this report be addressed for DNFBPs;
- consultation and outreach activities be undertaken to inform the DNFBP sectors of the CDD obligations under the FTRA, and ensure that the requirements are adapted to the nature of activities of DNFBPs.

4.1.3 COMPLIANCE WITH RECOMMENDATION 12

| | Rating | Summary of factors relevant to s.4.1 underlying overall rating |
|---|---|---|
| **R.12** | **Non-compliant** | • **The CDD requirements under the FTRA would cover all DNFBPs activities listed under Recommendation 12, but these requirements are not yet effectively in force.**<br>• **The deficiencies of CDD requirements applicable to financial institutions are also applicable to DNFBPs.**<br>• **The capability of authorities to enforce the requirements for casinos is doubtful.** |

## 4.2 SUSPICIOUS TRANSACTION REPORTING (R.16) (APPLYING R.13-15, 17 & 21)

### 4.2.1 DESCRIPTION AND ANALYSIS

412. As noted in section 4.1 of this report, DNFBPs are included in the definition of "Institution" in the FTRA and are therefore in law subject to the suspicious transaction reporting requirements contain in the FTRA. Section 7 of the FTRA requires every institution to make suspicious transaction reports (STRs) to the FIU. Similarly, the protections for reporting and prohibitions against tipping off contained in the FTRA apply also to DNFBPs.

413. However, as noted previously, the FIU and an effective STR regime is yet to be established in practice and the same deficiencies as those noted in section 3.7 of this report are applicable to DNFBPs.

**Applying Recommendations 13 and 14**

414. All DNFBPs included the definition of "Institution" in the FTRA, are subject to the requirement to report suspicious transactions. There is no distinction in the application of the reporting provisions to DNFBPs relative to financial institutions. The protection provisions in respect of reports made in good faith and the prohibition from unauthorised disclosure under the FTRA apply equally to DNFBPs.

**Applying Recommendations 15, 17 and 21**

415. The provisions of the FTRA apply equally to DNFBPs in relation to internal procedures; compliance; audit functions; training and hiring of employees and the application of sanctions.

416. However no specific provisions have been made in the matters concerning access to data by compliance staff and matters relating to the countries which insufficiently apply the FATF Recommendations, and the shortcomings in effective implementation of the provisions of the FTRA referred to above apply equally or more so to DNFBPs

Additional elements

417. As noted above, the requirements of the FTRA apply to accountants when they prepare for or carry out transactions for their clients in relation to certain activities. Thus it

is clear that the reporting requirements do not extend to the rest of the professional activities of accountants, including auditing.

418. Section 7 of the FTRA requires that where an Institution (which include DNFBPs) has reasonable grounds to suspect that any transaction or attempted transaction may be related to the commission of any unlawful activity or any other criminal offence shall report within two days of forming such suspicion to the FIU.

4.2.2 RECOMMENDATIONS AND COMMENTS

419. The FTRA has established the legal basis on which the DNFBPs must provide STRs under section 7 and cash transaction reports under section 6.

420. However, the shortcomings in legal arrangements, regulations and guidelines and their implementation noted above in relation to financial institutions apply also to the DNFBP sector. This situation is exacerbated by the fact that there are insufficient supervisors or SROs to facilitate implementation of FTRA across the various DNFBP sectors.

421. Sri Lanka should either establish supervisors for each of the sectors or to upgrade the industry associations to SRO status and require them to issue necessary directions, regulations and guidance to their members and to ensure compliance through periodic examination. Even a very developed and efficient FIU cannot replace the sectoral supervisors who have an in-depth understanding of their domains and can play a very important preventative role.

4.2.3 COMPLIANCE WITH RECOMMENDATION 16

| | Rating | Summary of factors relevant to s.4.2 underlying overall rating |
|---|---|---|
| **R.16** | **Non-compliant** | • **While DNFBPs are legally subject to the reporting and other requirements of the FTRA, effective supervision and implementation is lacking.**<br>• **Not all DNFBPs have a designated body (supervisor or SRO) to impose AML/CFT sanctions (applying Recommendation 17)** |

## 4.3 REGULATION, SUPERVISION AND MONITORING (R. 24-25)

4.3.1 DESCRIPTION AND ANALYSIS

**Recommendation 24**

422. There are no existing guidelines or mechanisms for monitoring and ensuring compliance of DNFBPs with AML/CFT requirements. As the FTRA is not yet fully in force and the structure and role of the FIU have not yet been determined, there is no clear picture on how compliance with the FTRA would be enforced. It has not been decided whether it would be the role or the FIU or the regulators or SRO of the specific sectors.

*Casinos*

423. Casinos, while currently operating in Sri Lanka, are not currently subject to any AML/CFT controls.

424. The legal status of casinos does not appear to be clear in Sri Lanka. The Gaming Ordinance defines "common gaming place" to include any place to which public may have access with or without payment and which is kept or used for betting or for playing of any game (for stake or not) of chance or of mixed chance and skill with an instrument or appliance the importation of which is prohibited in an order published in the Gazette. Playing, entry or escape from such a place is an offence punishable by fine or imprisonment or both. Thus it would appear that casinos are illegal in Sri Lanka.

425. However, in terms of the Betting and Gaming Levy Act, a levy is payable to the Ministry of Inland Revenue by a person carrying on business of gaming. The levy has been increased from time to time and presently stands at Rs. 50 million per year. It was stated during discussions with officials that there are in fact seven large casinos operating in Sri Lanka from which levies of Rs.340 million were collected in 2005.

426. Discussions with the officials of Ministry of Finance did not indicate any attempt having been made that only 'fit and proper' persons own or control casinos. The major concern being the ability of Inland Revenue Department to collect the levy for which it had to enlist the help of the Police authorities.

427. There does not appear to be uniformity of view among various officials with whom the issue was discussed as to whether there is contradiction in collecting levy under an Act of Parliament from casinos which are declared illegal under an Ordinance. Aside from collecting the levy, there is no actual supervision of casinos. Seven casinos are currently operating in Sri Lanka.

*Dealers in precious metals and stones*

428. Dealers in precious metals and stones (DPMS) in Sri Lanka are regulated under the National Gem and Jewellery Act, 1993 and are required to obtain a license from the National Gem and Jewellery Authority. The legislation applies mostly to the mining and export of jewels. These provisions do not apply to the sale and purchase of gold bullion, which is only allowed for banks under law.

429. The Sri Lanka Gems and Jewellery Association was formed four years ago as a result of amalgamation of four trade associations. The Association has 350 members and functions as a trade association only, not as an SRO. It has issued a code of ethics for its members but does not issue any circulars or guidelines for its members, and does not conduct any monitoring activities. The office bearers of the Association indicated that the Association could not be considered as a Self Regulatory Organization.

430. Industry representatives indicated that they had not received any communication from Government or any other authority in respect of AML/CFT issues. They also were not aware of the FTRA. It was stated that cash transactions did exist at the lower end of the value chain, such as mining.

431. Sri Lanka is part of the Kimberley Process Certification Scheme (KPCS), which prohibits participating countries from importing rough diamonds from countries not engaged in the Kimberley Process. The KPCS requires participating countries to export rough diamonds in tamper-resistant containers and provide a certificate, validated by the government of the export country, confirming that the diamond exports are conflict-free.

*Accountants*

432. The Institute of Chartered Accountants of Sri Lanka (ICASL), the Association of Certified Accountants and the Sri Lanka Division of the Chartered Institute of Management Accountants of the United Kingdom are the self-regulatory organizations for accountants in Sri Lanka. They prescribe ethical and professional standards for their members. Disciplinary procedures, such as suspension or loss of membership apply for violations of these rules. In addition, accounting standards are set by the Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) under the Sri Lanka Accounting and Auditing Standards Act No 15 of 1995.

433. Auditing can be done only by a member of ICASL. "Professional misconduct" has been defined in a long list of acts or omissions given in the Second Schedule to the Act of Incorporation of the Institute of Chartered Accountants of Sri Lanka, which however does not make any reference to duties to prevent money laundering or financing of terrorism. Members are also subject to code of ethics issued by the ICASL.

434. Though the Code of Ethics requires chartered accountants to observe confidentiality of client information, circumstances have been laid down when confidential information may be disclosed. Disclosures can be made when required under law or where there is a professional duty/right to disclose. The former includes evidence in course of legal proceedings, disclosure to the appropriate public authority or infringement of law which is brought to light. Violation of the Code of Ethics and professional misconduct leads to disciplinary procedure which consists of investigation by the Ethics Committee followed by references to Council and Disciplinary Committee. If found guilty, the punishment can range from 'reprimand' to loss of membership. It was indicated during meetings with ICASL that on an average eight to ten cases of disciplinary proceedings are handled in a year. Further, members are subjected to Peer Review and Practice Review. Discussions with the officials of ICASL indicated that the practice of dealing in moneys and accounts on behalf of clients and forming companies in anticipation of handing over the same to clients is not a common practice in Sri Lanka, although the law does not prevent it.

435. The Sri Lanka Accounting and Auditing Standards Act and the regulations made under the Act have defined certain enterprises to be "specified enterprises" which includes banks, finance companies, security companies, insurance companies, other legal companies and companies providing services. The Act applies mainly for the preparation, presentation and audit of financial statement of the enterprises in respect of periods commencing on or after 1 January 1999. The Act imposes certain duties and obligations on specified business enterprises and their directors, officers and auditors, the default of which would result in various penalties, extending up to an imprisonment of either description for the term of five years.

436. Every specified business enterprise is required to:

i. prepare its financial statement in compliance with the Sri Lanka Accounting Standards and take all necessary measures to ensure all the financial are audited in accordance with Sri Lanka Auditing Standards with the object of presenting a true and fair view of financial performance and financial position of such enterprise;
ii. to have financial statements audited by the members of The Institute of Charted Accountant In Sri Lanka holding a certificate to practice issued by the Institute;
iii. submit a copy of annual financial statements of the enterprise to the Sri Lanka Accounting and Auditing Standards monitoring board, to enable the Board to determine whether the financial statements have been prepares in compliance with Sri Lanka Accounting Standards ; and

iv. to furnish to the board or any person authorised by the Board any information pertaining to its financial statements as may be required by the Board or any person authorised by the board within such time, as may be specified in the notice issued by the Board or any person authorised by it

437. Every company, which is a specified business enterprise is required to submit its annual audited financial statements to the Board at the same time as it is required to submit the same to its members. Every specified business enterprise is requested to submit 2 copies of the annual report as required, at the address given overleaf, and obtain a receipt of the same.

*Legal profession*

438. Legal professionals, solicitors, and barristers in Sri Lanka are regulated by the Supreme Court, which determines eligibility for admission to the legal profession and issue rules on their conduct. Discussions with the Bar Association of Sri Lanka indicated that it is an unincorporated society. However, the Judicature Act recognises the Bar Association, which acts as a Self-Regulatory Organization (SRO) for the profession. It has certain disciplinary roles and lays down modalities for calling to layers to the bar, taking of oaths etc. The Bar Association also has role in continuing education program for the lawyers. However, ultimate power over members lies with the Supreme Court.

*Trust and Company Service Providers*

439. Meetings with Institute of Chartered Accountants, Bar Association, and Registrar of Companies indicated that there was very little awareness about the Trust and Company Service Providers in Sri Lanka. It appears that there is nothing in the statute or regulations to prohibit provision of these services and a few Chartered Accountants and lawyers act as Trust and Company Service Providers but the service is not popular.

*Real estate*

440. Discussions with one real estate company, which among its other activities grants housing loans etc, indicated that real estate agents are not subject to any regulatory or supervisory regime, and there is no licensing or registration system. There is no SRO that regulates or supervises real estate. There is also no industry association of real estate agents.

**Recommendation 25**

441. No AML/CFT guidelines for DNFBPs have been issued by either the government or SROs.

4.3.2 RECOMMENDATIONS AND COMMENTS

442. The fact that casinos are not explicitly legal may not, make them an ideal instrument for money laundering, as they do not offer the same appearance of legitimacy as other financial intermediaries. However, such a situation facilitates the ownership or control of casinos by elements of the organized crime.

443. It is recommended that:

- Casinos should be subject to comprehensive AML/CFT regulation and supervision through the FTRA.

- the legal status of casinos in Sri Lanka be clarified, either by imposing and enforcing a prohibition on casino operations; or explicitly legalizing casinos and establishing a licensing and supervisory regime, including measures to prevent the ownership, control or management of casinos by criminals;
- consideration be given to establishing a regulator or SRO for the real estate sector;
- AML/CFT guidance be formulated and issued for each industry in the DNFBP sector;
- discussions be undertaken with the regulators and SROs of the DPMS sectors to determine the extent of their role in monitoring and ensuring compliance with the FTRA.

4.3.3 COMPLIANCE WITH RECOMMENDATIONS 24 & 25 (CRITERION 25.1, DNFBP)

| | Rating | Summary of factors relevant to s.4.3 underlying overall rating |
|---|---|---|
| **R.24** | **Non-compliant** | • **There is no AML/CFT supervision for casinos or other DNFBPs** |
| **R.25** | **Non-compliant** | • **There are no existing guidelines for DNFBPs with regard to their obligations to comply with AML/CFT measures.**<br>• **There is no guidance on the obligations faced by DNFBPs to report suspicious or other transactions to a competent authority (e.g. FIU).** |

## 4.4 OTHER NON-FINANCIAL BUSINESSES AND PROFESSIONS – MODERN SECURE TRANSACTION TECHNIQUES (R.20)

### 4.4.1 DESCRIPTION AND ANALYSIS

**Recommendation 20**

444. DNFBPs, as defined in the FTRA, include gambling houses and investment managers.

445. Sri Lanka has not yet undertaken a formal risk assessment of vulnerabilities to non-financial businesses and professions other than DNFBPs.

446. It does not appear that auction houses are an important business in Sri Lanka. However, pawnshops are common.

447. Sri Lanka does not issue bank notes in denominations higher than 1000 rupees, which is equivalent to approximately US$10. Sri Lankan authorities did not outline any particular steps that had been taken to reduce reliance on cash.

448. CBSL has taken several steps in the area of Payment and Settlements Systems. It is pertinent to quote from the Financial Stability Review, 2005

> *" The CBSL owns and operates the LankaSettle System which comprises the RTGS System; and the "Scripless Securities Settlement System(SSSS) and Scripless Securities Depository System (SSDS) jointly known as the LankaSecure System. LankaSettle, which settles close to about 83 per cent of the total value of non-cash LKR payments, is considered a systemically important Payment and Settlement System. The total value of transactions effected through the RTGS system during 2005 was LKR 17,543 billion, about 8 times Sri Lanka's GDP.*

*Most low value transactions are made using cheques/drafts and the majority of such cheques / drafts are cleared by LankaClear (Pvt.) Ltd. The total value of cheques/drafts cleared accounts for about 15 per cent of the total value of non-cash payment and has a system wide importance.*

*The contribution of all other non-cash payments means including credit cards, debit cards, direct credits/debits under the Sri Lanka Inter bank Payment System (SLIPS), internet banking, tele-banking and mobile banking accounts of the balance 2 percent of the to a value of non-cash payments."*

### 4.4.2 RECOMMENDATIONS AND COMMENTS

449. It is recommended that:

- The authorities may consider formally assessing vulnerabilities of other non-financial businesses and professions and consider the need for any further regulatory AML/CFT coverage of this area.

- Measures should be developed to reduce the reliance on cash and to encourage the development and use of modern and secure techniques for conducting financial transactions that are less vulnerable to money laundering and terrorist financing.

### 4.4.3 COMPLIANCE WITH RECOMMENDATION 20

| | Rating | Summary of factors relevant to s.4.4 underlying overall rating |
|---|---|---|
| **R.20** | **Partially Compliant** | • **Sri Lanka has not yet undertaken a formal risk assessment of vulnerabilities to non-financial businesses and professions other than DNFBPs.**<br>• **No particular measures have been taken to reduce reliance on cash.** |

# 5 LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANISATIONS

## 5.1 LEGAL PERSONS – ACCESS TO BENEFICIAL OWNERSHIP AND CONTROL INFORMATION (R.33)

### 5.1.1 DESCRIPTION AND ANALYSIS

450. The Registrar of Companies administers the Companies Act, the Societies Act, the Public Contracts Act and the Theetus Ordinance (or "Chit Funds"). All companies in Sri Lanka must register under the Companies Act No. 17 of 1982. There are three kinds of companies:

i. Private companies: a private company must consist of at least two and not more than 50 members and must have at least one director. A private company cannot invite public subscription for its shares.

ii. Public companies: a public company must have at least seven members (no upper limit) and at least two directors. Public companies may invite public subscriptions for their shares or debentures and other securities, and can also be listed on the stock exchange. They cannot commence business without a business commencement certificate.

iii. Off shore companies: a company registered within or outside Sri Lanka may register itself in Sri Lanka as an "offshore company" to carry on any business outside the shores of Sri Lanka. If a company registered outside Sri Lanka registers itself as an offshore company, it is deemed to have been incorporated in Sri Lanka, however, such company cannot conduct any business in Sri Lanka.

451. Regardless of the type of company, all companies must centrally register with the Registrar of Companies. A number of documents are required including a Memorandum and Articles of Association together with a number of forms one of which (Form 47) is a "List of Persons who have Consented to be Directors." The Registrar examines these documents and approves them in the form and content required under the Companies Act. If he approves them, he may also approve incorporation.

452. All companies must maintain a register of past and present members which contains their names and addresses, nationality, principal occupations, numbers of shares held, the date of their share registration and the date of any transfer of their shares (section 108). Failure to comply with these requirements is an offence under section 108(2) punishable by a "default fine."

453. Companies are also required to file annual returns (Form 63) every year with the Registrar which must contain the names (including former names) of directors and secretaries, their nationality, usual address and business occupation (section 120) as well as the number of shares held by each specifying any shares transferred from the last return.

454. In terms of identification of natural persons, the Registrar of Companies confirmed that if two companies form a third private company the Companies Act does not require the identification of the natural persons standing behind the forming companies – only particulars of the forming companies.

455. The Registrar may share information on the public register or information gained by the investigative mechanisms discussed below with other jurisdictions on a cooperative basis. For criminal investigations overseas, the information would be provided through mechanisms under the Mutual Assistance in Criminal Matters Act.

456. All changes of ownership of shares as well as change of any director of a company whether due to appointment or resignation are required to be notified to the Registrar of Companies in the prescribed form. This information is available to the general public and to competent authorities.

457. Under section 432, if the Registrar considers it necessary for "any purpose" under the Act he, or one or more competent inspectors on his behalf, may carry out an investigation or inquiry into the affairs of the company. The Act grants wide ranging powers for this purpose at sections 161 to 165 inclusive. The powers extend to permit the Registrar to investigate subsidiaries and holding companies as well as subsidiaries and holding companies of those subsidiaries, etc. There are a number of sanctions available to the Registrar or his inspectors to enforce their powers.

458. In addition, under section 169 the Registrar has wide powers to inquire into the ownership structure of a company. Where there is "good reason" he may appoint one or more persons to investigate and report on the membership of any company to determine the "true persons who are, or have been, financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence the policy of the company." There are similar powers for the Registrar to inquire into share ownership (section 170).

459. Sri Lankan law does not permit bearer shares. Nor does it permit limited partnerships (whether incorporated or unincorporated). The Registrar of Companies advised the evaluation team that trust and company service providers (in Sri Lanka they are primarily chartered accountants and lawyers) are not required to obtain, verify and retain records of the beneficial ownership and control of legal persons.

460. Shareholder and company officer information is publicly available at the Registrar's office.

### 5.1.2 RECOMMENDATIONS AND COMMENTS

461. The Evaluation Team was informed that a draft Bill to replace the Companies Act No. 17 of 1982, first prepared in 1994 by a New Zealand drafting consultant, is due to be presented to Parliament within months. What changes this Bill will introduce on the issues of beneficial ownership and other issues is unknown.

462. Sri Lanka should:

- Require trust and company service providers to obtain, verify retain beneficial control information when acting for natural persons in forming corporate entities, and
- Broaden the requirements to record beneficial ownership information on companies to ensure that information on natural persons is included when the forming entities of companies are two or more other companies.

### 5.1.3 COMPLIANCE WITH RECOMMENDATION 33

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.33** | **Partially Compliant** | • **Trust and company service providers are not required to obtain, verify and retain records of the beneficial ownership and control of legal persons**<br>• **Sri Lanka should extend the rules relating to beneficial ownership information** |

## 5.2 LEGAL ARRANGEMENTS – ACCESS TO BENEFICIAL OWNERSHIP AND CONTROL INFORMATION (R.34)

### 5.2.1 DESCRIPTION AND ANALYSIS

463. Sri Lanka is a common law country with some elements of Dutch civil law still apparent. However, with respect to legal persons, Sri Lanka does recognize express trusts as vehicles which can own assets and establish legal relationships with financial institutions.

464. There are, however, no central registries to identify parties (settlor, trustee and beneficiary) to an express trust nor is there any general legal requirement to obtain, verify or retain information on the beneficial ownership and control of such trusts.

465. However, if such a trust operates under a business name it is required to register that name and in doing so disclose the name of the primary natural person(s) operating the trust – but not, however, the beneficiaries. Or, if the trustee requires a business licence to conduct any business it will be required to disclose the similar name(s). In addition, if the trust is an incorporated entity it must file annual returns with the Registrar of Companies as discussed in the previous section which requires disclosure of information under the Companies Act.

466. The CBSL's Directive, 02/04/004/0012/001 *Guidelines on Customer Due Diligence – Know Your Customer Procedure*, issued to Licensed Commercial Banks and Licensed Specialized Banks only, provides that in the case of Trust/Fiduciary accounts and partnerships "the identity should be established in respect of each signatory to the account." The directive does not require those Banks to verify the identity of trustees, settlers, grantors, protectors, and beneficiaries - only signatories.

467. Likewise, the newly enacted FTRA does not provide specific express trust customer due diligence for financial institutions when transacting business with those trusts.

### 5.2.2 RECOMMENDATIONS AND COMMENTS

468. In general, there are no requirements to obtain verify and retain information about trusts – in particular the settlor, trustee and beneficiary - except in very limited circumstances as discussed.

469. There is considerable scope to introduce or improve the processes in place to enable competent authorities to obtain or have access in a timely fashion to information on beneficiary ownership and control of trusts. Sri Lanka should enact more comprehensive measures to require that this data be collected or otherwise ensure that it can be made available in a timely manner.

### 5.2.3 COMPLIANCE WITH RECOMMENDATIONS 34

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.34** | **Partially Compliant** | • **Competent authorities have some powers to obtain access to information on the beneficial ownership and control of certain legal arrangements. Overall, the mechanisms in place are insufficient.** |

## 5.3 NON-PROFIT ORGANISATIONS (SR.VIII)

### 5.3.1 DESCRIPTION AND ANALYSIS

470. The non-governmental organisation sector in Sri Lanka consists of organisations registered under the Voluntary Social Service Organizations Act No.31 of 1980, non profit seeking companies registered under section 21 of the Companies Act No. 17 0f 1982, and organizations established by acts of Parliament.

471. A large portion of this sector is constituted by voluntary organisations, which must be registered under the Voluntary Social Service Organizations (Registration and Supervision) Act No.31 of 1980. The term "voluntary social services organizations", defined as an organisation with voluntary participation, of non-governmental nature dependent on public contributions, donations or grants from the Government and that provides relief and services for the mentally retarded or physically disabled the poor the sick, the orphans and destitute, and the provision of relief to the needy in times of disaster. The Companies Registrar insists that companies registered under Companies law to register under the Act No.31 of 1980. The maximum fine for a violation of the requirements of the Voluntary Social Service Organizations (Registration and Supervision) Act is only 250 rupees.

472. NGOs are registered with the Ministry of Social Welfare and Social Services, which provides a certificate of registration. The required application includes information such as the NGO's objectives and intended activities, name and coordinates of the organization and its key employees. A copy of a legal status document such as the constitution must be provided. NGOs with existing activities in other countries seeking registration in Sri Lanka have to furnish information on their experience in voluntary services activities in these countries. A minimum capital requirement is a condition for registration, as evidence that sufficient funding is available for the NGO's activities. There is legal requirement to submit annual financial statements upon application. The Registrar of the Voluntary organizations has been empowered to call for audited annual reports and any other information in respect of conduct of such organizations.

473. NGO registration applications are submitted at either the national, district or divisional level. The National Secretariat is responsible for the registration of all foreign originated organizations, locally originated organizations that are at least in part foreign funded, as well as organizations having activities in more than one Administrative District. The 25 District Secretariats register organizations with activities limited to respective administrative districts. Finally, Divisional Secretariats register organizations in respective divisional Secretariat area. Each Administrative District consists of a number of Divisional Secretariat areas.

474. Applications for registration are referred to the Ministry of Foreign Affairs (for those with activities outside Sri Lanka) and the Ministry of Defence, which may

recommend their rejection if there are concerns about possible criminal activities or other security concerns. The National Secretariat's website provides a list of about 1000 NGOs registered at the national level.

475. NGOs are required to sign a MOU with the line Ministry under which the subject matter of the NGO is administered. The draft MOU must be provided along with the application to the Ministry of Social Welfare and Social Services, which forwards it to the relevant line Ministry with a recommendation. The relevant Secretariat also provides recommendation letters to facilitate the issuance of visas to foreign residents that wish to engage in NGO activities in Sri Lanka, as well as recommendations to open bank accounts in Sri Lankan currency.

476. The NGO Secretariat is authorised to inspect the premises of an NGO to ensure that funds are used in accordance with the stated objectives, and require an audit of the organisation's accounts. The Secretariat currently does not however have adequate resources to conduct such activities.

477. Charities in Sri Lanka are not exempted from paying income tax, and are required to file an income tax return with the Inland Revenue Department. They are however eligible to a lower tax rate. Under the Inland Revenue Act of 2000, the income tax rate applicable to "charitable institutions" is 10 percent, compared to 30 percent for corporations. Also, donations made by individuals and companies to an "approved charity" are deductible from taxable income. Charities seeking eligibility for this benefit must submit an application to the Inland Revenue Department. A list of "approved charities" is available on the Inland Revenue Department web site. Approved charity status is granted on the recommendation of the National Secretariat of NGOs.

478. In the months following the December 2004 tsunami, charitable donations from all over the world flowed into Sri Lanka. The funds were channelled through existing NGOs as well as a large number of new ones that established operations in Sri Lanka to provide relief to the victims and help reconstruction.

479. The Controller of Exchange issued, in February and May 2005, operating instructions to commercial banks in respect of NGOs. These instructions specify that all remittances received from abroad by NGOs operating in Sri Lanka should be channelled into a "Post Tsunami Inward Remittances Account", and that appropriate KYC measures should be performed with respect to the NGO and the signatories of the account. Monthly statements of the accounts are to be sent to the Exchange Control Department of the CBSL.

480. Although the Exchange Control Department also monitors fund flows into NGO accounts to determine whether they could be linked to terrorist financing, the authorities admit having difficulties tracking the money coming out of the special accounts and ensuring that it is in effect used to provide relief to tsunami victims.

481. In February 2005, the Non-Governmental Sector Unit was created with the Ministry of Finance to streamline the NGO application process. The Unit evaluates applications and obtains the required clearance from the Ministry of Foreign Affairs and the Ministry of Defence. The Unit does not review NGOs that obtained registration before February 2005.

482. Authorities in Sri Lanka have become aware that the existing NGO legislation is inadequate and that the government lacks the capability to ensure that funds are collected in an acceptable manner and that the funds are used in accordance with the NGOs' stated charitable objectives and not be misused for terrorist financing.

Accordingly, Cabinet has established, in February 2006, an independent committee to review the NGO legislation and conduct public consultations on the issue. The committee is to provide a public report of its findings within 3 months of its creation. The potential abuse of NGOs for the funding of terrorist is not the main focus of this review.

483. Areas for review include:

- increasing the information requirement in the application;
- ensuring that funds support the NGO's activities as opposed to be distributed to the members;
- in addition to the registration, possible issuance a fund collection certificate;
- adding an authority to cancel registration;
- increasing penalties for contravention of the law.

484. One proposed measure includes the creation of District Coordinating Committees that will investigate voluntary organizations monthly based on action plans and self governing tools of the organization against the actual performance of itself, and legal framework, policy framework and accepted norms of the society after due approval from the respective authorities. The committees will share information with law enforcement in respect of the possible criminal use of NGOs through local police and with FIU through the National Secretariat. Although, as noted above, terrorist financing is not the main focus of the review of the legislation, it has been pointed out to the team of assessors that District Coordinating Committees will be expected to examine the abuse of NGOs for terrorist financing.

5.3.2 RECOMMENDATIONS AND COMMENTS

485. Sri Lanka is conducting a review of its NGO legislative framework to prevent the misappropriation of funds received by these organizations and improve compliance monitoring and sanctions. It is recommended that scope of the review include the risk of use and abuse of NGOs to fund terrorist activities.

486. To address those risks it is recommended that:

- effective coordination and information sharing mechanisms be implemented between the NGO regulatory authorities (including the Inland Revenue Department and the Ministry of Social Welfare and Social Service), the future FIU and law enforcement to share information on possible terrorist financing through NGOs;
- specific CDD requirements be applicable to institutions subject to the FTRA in respect of NGO accounts (e.g. request registration certificate, obtain information on the objectives and activities as well as directors / members);
- specific guidance and indicators be developed in respect of suspicious transaction reporting involving NGOs;
- ensure the financing transparency of NGOs (e.g. by requiring that annual financial statements be filed with the authorities);
- outreach be conducted among the NGO sector to raise awareness on the risks of abuse for funding terrorism;
- increased penalties be introduced for violations of the legislation and regulations applicable to NGOs;
- the authorities be provided with adequate resources to monitor the NGO sector.
- Sri Lanka implement all other elements included in the Interpretative Note to SR VIII.
- Sri Lanka consider implementing other elements of the SR VIII Best Practices Paper.

### 5.3.3 COMPLIANCE WITH SPECIAL RECOMMENDATION VIII

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **SR.VIII** | **Partially compliant** | • **Sri Lanka is conducting a comprehensive review of its NGO legislative framework. However, the review is not focused on terrorist financing.**<br>• **There has been no assessment of the overall vulnerabilities of the non-profit sector to terrorist financing or other abuse.**<br>• **There is insufficient monitoring of NGOs to ensure funds are used to achieve charitable objectives.**<br>• **There are no requirements to ensure the financial transparency of the NGO sector.**<br>• **There has been no education to NGOs on how to protect themselves from terrorist financing and other abuses.**<br>• **There is no specific guidance issued to financial institutions in respect of customers that are NGOs.** |

# 6 NATIONAL AND INTERNATIONAL CO-OPERATION

## 6.1 NATIONAL CO-OPERATION AND COORDINATION (R.31 & 32)

### 6.1.1 DESCRIPTION AND ANALYSIS

**Recommendation 31**

487. Sri Lanka has begun to put in place mechanisms to address co-operation at both the operational level and, in particular in recent times, the policy level. There are however areas where co-operation and co-ordination could be further enhanced, especially as progress is made in establishment of the FIU and the implementation of the FTRA and PMLA generally.

*Operational co-operation and co-ordination*

488. In relation to operational co-operation and co-ordination generally, some mechanisms exist to co-ordinate the analysis, assessment and investigative capabilities of a range of agencies, but not specifically in relation to ML and TF.

489. As noted in section 2.6 of this report, the Sri Lankan Police Department, specifically the CID, will be primarily responsible for the investigation of ML and FT offences, though other agencies (such as the Commission to Investigate Allegations of Corruption and Bribery, the Exchange Control Department of the CBSL and the Customs Department) will also have a role to play. Section 2.6 of this report includes a recommendation that effective national mechanisms be set up to enable good coordination and cooperation between policy makers, the FIU, law enforcement and other competent authorities in Sri Lanka in combating ML and TF activities, and the Evaluation Team believes that such action will be vital to ensure that ML and FT are effectively investigated and use of resources optimised.

490. Sri Lankan authorities see the establishment of a multi-disciplinary FIU as a central 'clearing house' and centre of expertise in relation to ML and TF as playing a central part in both operational and policy coordination efforts in Sri Lanka. However, as the FIU is not yet operational, it still has not been determined precisely how the FIU will co-operate with the other domestic authorities in relation to operational and policy aspects concerning money laundering and terrorist financing matters. This matter is currently under consideration by Sri Lankan authorities.

*Policy co-operation and co-ordination*

491. Sri Lanka has recognised the importance of effective policy co-operation and advised the Evaluation Team that the Ministry of Finance, Ministry of Foreign Affairs, Ministry of Justice, Ministry of Defence, CBSL, Customs Department, Attorney-General's Department, National Intelligence Secretariat and the Commission to investigate Bribery and Corruption had worked together to get the Convention on Suppression of Terrorist Financing Act No.25 of 2005 enacted in August 2005 and the PMLA and FTRA enacted in March 2006..

492. As noted previously, a Steering Committee for the FIU under the Ministry of Finance has very recently been set up to co-ordinate all concerned parties and oversee the establishment of the FIU office and related issues. The Evaluation Team commends this approach and the establishment of this Committee, which has the potential to play a broader, ongoing national coordination role in relation to AML/CFT matters in Sri Lanka.

Additional elements

493. The Sri Lankan authorities advise that, once the FIU is established, further action will be taken to improve the level of consultation between competent authorities, the financial sector and other sectors (including DNFBPs) that are subject to AML/CFT laws, regulations, guidelines or other measures. As noted elsewhere in this report, this will be vital for effective implementation of the new laws across all relevant sectors. .

**Recommendation 32**

494. Because of its own domestic situation, Sri Lanka has recognised the urgent need to significantly improve the effectiveness of its AML/CFT systems and the recent passage of the Convention on Suppression of Terrorist Financing Act, the PMLA and the FTRA reflects this recognition in a concrete way.

495. Given the nascent nature of the AML/CFT system in Sri Lanka, there have as yet been no reviews of implementation of AML/CFT systems.

### 6.1.2 RECOMMENDATIONS AND COMMENTS

496. The overall level of co-operation and co-ordination is improving, and the recent establishment of the Steering Committee, and the eventual operationalising of the FIU later in 2006, will further improve the situation at both the policy and operational levels.

497. There is however significant scope to improve the level of co-operation and co-ordination between all relevant law enforcement agencies and also to enhance co-ordination at the policy level, possibly through the establishment of a formal national co-ordination mechanism, building on the recently established Steering Committee for the FIU, to include all relevant departments and agencies.

498. Sri Lanka should ensure there are effective mechanisms put in place to enable policy makers, the FIU, law enforcement and other competent authorities to co-operate with each other to develop and implement policies to combat ML and FT.

### 6.1.3 COMPLIANCE WITH RECOMMENDATION 31

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.31** | **Partially compliant** | • **Some mechanisms have been put in place but there is scope to improve co-operation/co-ordination at both operational and policy levels.**<br>• **The FIU is not operational and it is not yet clear exactly how the FIU will co-operate with the other domestic authorities in the relation to operational and policy aspects concerning money laundering and terrorist financing matters.** |
| **R.32** | **Partially compliant** | • **Previous reviews of effectiveness have resulted in passage of significant legislation in recent times.**<br>• **Given the nascent nature of the AML/CFT system in Sri Lanka, there have as yet been no reviews of implementation of AML/CFT systems.** |

## 6.2 THE CONVENTIONS AND UN SPECIAL RESOLUTIONS (R.35 & SR.I)

### 6.2.1 DESCRIPTION AND ANALYSIS

499. Sri Lanka has acceded to the Vienna Convention and has ratified the UN International Convention on the Suppression of Terrorist Financing (8 September 2000), but has not ratified the Palermo Convention.

500. The Terrorist Financing Convention has been incorporated into domestic law through the Convention for the Suppression of Terrorist Financing Act No. 25 of 2005 as discussed in Part 2.2. UN Security Council Resolutions 1267 and 1373 have only been partially implemented as discussed in Part 2.4. Deficiencies exist in the implementing legislation and framework as noted in those sections.

### 6.2.2 RECOMMENDATIONS AND COMMENTS

501. Sri Lanka should ratify the Palermo Convention as soon as possible as well as take steps to more fully and effectively comply with UN Security Council Resolutions 1267 and 1373.

### 6.2.3 COMPLIANCE WITH RECOMMENDATION 35 AND SPECIAL RECOMMENDATION I

| | Rating | Summary of factors underlying rating |
|---|---|---|
| **R.35** | **Partially Complaint** | • **Sri Lanka has not ratified the Palermo Convention** |
| **SR.I** | **Partially Complaint** | • **Sri Lanka has not fully implemented the Terrorist Financing Convention**<br>• **Sri Lanka has not fully implemented UN Security Council Resolutions 1267 and 1373** |

## 6.3 MUTUAL LEGAL ASSISTANCE (R.32, 36-38, SR.V)

### 6.3.1 DESCRIPTION AND ANALYSIS

502. The Sri Lankan mutual legal assistance framework is contained primarily in the Mutual Assistance in Criminal Matters Act, No. 25 of 2002 and in the PMLA and Convention on the Suppression of Terrorist Financing Act so far as the former is amended by those two Acts to include the money laundering and terrorist financing offences within the mutual legal assistance rules. This point is relevant to Recommendations 36, 37 and 38 discussed below with respect to Special Recommendation V.

**Recommendation 32**

503. Sri Lanka was requested to provide comprehensive statistics on mutual legal assistance including the nature and number of requests over the last number of years, how many requests were granted and how many refused and for what reasons as well as the length of time it takes to process such requests. Subsequent to the on-site visit, Sri Lanka provided information which indicated that two mutual legal assistance requests had been received by Sri Lanka in 2004. Despite requests from the Evaluation Team, no further statistics were provided and it would appear therefore that such statistics are not maintained or readily available.

**Recommendation 36 and Special Recommendation V**

504. The Secretary of Justice is designated the "central authority" under the Mutual Assistance in Criminal Matters Act. The Act allows Sri Lanka to provide a wide range of legal assistance including:

a. location and examination of witnesses;
b. obtaining and service of documents and evidence;
c. facilitating the personal appearance of witnesses including those in custody;
d. tracing of proceeds of crime, including identifying, locating and assessing the value of property derived directly or indirectly from an offence in the requesting country;
e. enforcement of foreign forfeiture orders; and
f. execution of search and seizure warrants against persons or property to locate and secure anything in relation to the commission of an offence in the requesting country.

505. The PMLA and the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 specifically provide that the provisions of the Mutual Assistance in Criminal Matters Act apply to money laundering and terrorist financing offences respectively. Points (d), (e) and (f) in the above paragraph generally meet the requirements of the FATF methodology in relation to Recommendation 36 except that there is no mechanism to render assistance in relation freezing orders or the instrumentalities of crime and assets of corresponding value – this issue is discussed in detail at section 2.3 of this report.

506. The Act is structured so that:

- Commonwealth counties do not require a mutual legal assistance treaty (so long as they as specified in an order published in the Gazette) to be granted assistance when required
- All other countries require an agreement/treaty as well as a specification order issued by the Minister of Foreign Affairs published in the Gazette before assistance may be provided under the Act.

507. The Sri Lankan authorities did not indicate how many Commonwealth countries had been specified nor how many agreements it had entered into with non-Commonwealth countries. It is therefore not possible to assess the effectiveness of the Acts provisions in this regard.

508. Requests for assistance must be made in a specified format and accompanied by documentation as required by the central authority. Officials from the Ministries of Justice and Foreign Affairs advised that requests are processed as quickly as possible but that completion times vary with the complexity and nature of the requests. There is no set time frame in statute or average time to complete such requests. There is, however, no departmental guidance or policy on handling or prioritizing mutual legal assistance requests.

509. Section 6 of the Act provides that assistance may be refused where a request relates to:

- an act which would not be an offence if committed in Sri Lanka;
- prosecution or punishment of an offence of a political character;
- a military offence;

- an offence or a similar offence for which the person was acquitted or convicted in Sri Lanka; or
- prosecution or punishment on the basis of race, religion, language, caste, sex, political opinion or place of birth.

510. There are two provisos to this (dual criminality is discussed below). An offence is not deemed to be of a "political character" where the offence is contained in an international convention to which Sri Lanka and the requesting State are both parties and there is an obligation to prosecute or extradite the person involved.

511. The Act contains few impediments to granting assistance to a requesting State. Requests cannot be refused on fiscal grounds or on the grounds of secrecy or confidentiality. There do not appear, however, to be any procedures or rules to assist in resolving competing jurisdictional claims for persons subject to prosecution in more than one jurisdiction nor has Sri Lanka considered devising such a framework.

512. The powers referred to under FATF Recommendation 28 to compel production of, search persons for, and seize and obtain transaction records, identification data obtained through the CDD process and other data listed in that Recommendation are available to authorities in Sri Lanka under Part VI of the Mutual Assistance in Criminal Matters Act. Under that Part an authorised Police officer must apply to a Magistrate for judicial authority (warrant) to proceed. Direct requests (from authority to authority), however, cannot be entertained.

**Recommendation 37 and Special Recommendation V**

513. Although section 6 of the Mutual Assistance in Criminal Matters Act specifically requires that an act, or acts, in relation to which mutual assistance is sought from Sri Lanka must, if they occurred in Sri Lanka, be an offence, the Act nevertheless provides that the central authority (Secretary of Justice) may grant such assistance for acts or omissions of a serious nature (in the opinion of the Secretary) and they are "criminal matters" within meaning of the Act. "Criminal matter" is defined to mean violations of any law of Sri Lanka or a specified country (Commonwealth or treaty country) including tax violations, exchange control, customs, securities or money laundering matters.

514. The Act does not provide that voluntary witness interviews or testimony, voluntary production of documents or evidence or production of publicly available documents or other less intrusive or non-compulsory matters do not require dual criminality for such assistance to be provided.

**Recommendation 38 and Special Recommendation V**

515. While the Act provides for identification and seizure of assets used for criminal purposes (Part VII and VI respectively) it does not provide for freezing of laundered property, or the freezing of the proceeds from, or the instrumentalities used in or intended to be used in, the commission of money laundering or terrorist financing offences.

516. Sri Lankan officials advised that because the Act clearly identifies money laundering as a "criminal matter" for the purposes of the Act, then the mechanisms for identification, freezing, seizure or confiscation such assets or property in the PMLA apply. However, the PMLA clearly provides at section 27(1) that the provisions of the Mutual Assistance in Criminal Matters Act apply to the former and not the other way around – in other words, the former does not extend the terms of the latter.

517. Property of corresponding value cannot be confiscated under the Mutual Assistance in Criminal Matters Act. Nor does Sri Lanka have arrangements with other countries for coordinated seizure and confiscation actions. An asset forfeiture fund also does not exist in Sri Lanka. Officials from the Attorney-General's office advised that confiscated funds or other assets are deposited into Government general revenue.

518. However, section 22 of the PMLA does provide that Sri Lanka may share forfeited or confiscated assets (or similar value) with other jurisdictions either under an agreement with the other country or on an *ad hoc* basis (in the interests of comity) where the Minister in charge of administering the Act in consultation with the Minister of Finance consider it appropriate.

519. As noted earlier in this Report (in relation to Recommendation 3 in section 2.3), Sri Lanka does not have a civil forfeiture system and neither does the Mutual Assistance in Criminal Matters Act permit the enforcement of foreign civil forfeiture orders in Sri Lanka. Section 19(1) of that Act provides clearly that foreign forfeiture orders must relate to proceedings in a criminal matter before the central authority will exercise his discretion to require the Attorney-General to apply for High Court registration of the order.

### 6.3.2 RECOMMENDATIONS AND COMMENTS

520. The Mutual Assistance in Criminal Matters Act is a good framework for providing and requesting assistance to and from overseas jurisdictions. It can be made more effective to address shortcomings in the light of FATF standards are follows:

- Sri Lanka should maintain accurate records in relation to mutual legal assistance including, the annual number and nature of requests, how long each request takes to process, whether an why requests are refused and a list of countries which are specified under the legislation and those for which there is a treaty;
- Sri Lanka should permit foreign freezing orders to be enforced and allow for the instrumentalities and property of corresponding value to be confiscated;
- Sri Lanka should give thought to preparing departmental or policy guidance on prioritizing MLA requests;
- The Act should provide that MLA can be provided for less intrusive or non-compulsory matters in the absence of dual criminality (and not just for serious matters as the Act currently does).

### 6.3.3 COMPLIANCE WITH RECOMMENDATIONS 32, 36 TO 38, AND SPECIAL RECOMMENDATION V

| | Rating | Summary of factors relevant to s.6.3 underlying overall rating |
|---|---|---|
| **R.32** | **Non-Compliant** | • **Very few statistics were available on MLA requests** |
| **R.36** | **Partially Compliant** | • **It is not clear whether Sri Lanka provides assistance in timely manner**<br>• **Sri Lanka has not considered devising a framework for resolving competing jurisdictional claims where prosecution in more than one country is at issue** |
| **R.37** | **Largely Compliant** | • **Dual criminality should not be applied for less intrusive or non-compulsory matters** |
| **R.38** | **Partially** | • **Sri Lanka cannot freeze laundered property or the** |

| | Compliant | instruments used in or intended to be used in offences<br>• Sri Lanka cannot confiscate property of corresponding value<br>• Sri Lanka has not considered establishing an asset forfeiture fund<br>• Sri Lanka does not have arrangements with other countries for coordinated seizure and confiscation actions |
|---|---|---|
| SR.V | Partially Compliant | • It is not clear whether Sri Lanka provides timely assistance<br>• Dual criminality should not be applied for less intrusive or non-compulsory matters<br>• Sri Lanka cannot confiscate the instruments used in or intended to be used in offences<br>• |

### 6.4 EXTRADITION (R.32, 37 & 39, & SR.V)

6.4.1 DESCRIPTION AND ANALYSIS

521. Under the Extradition Act No. 8 of 1977, extradition can be provided by Sri Lanka to Commonwealth countries specified by gazetted order of the Minister of Foreign Affairs (the central authority). Non-Commonwealth countries require a treaty or agreement which the Minister must also gazette. Sri Lanka has signed two extradition treaties with non-Commonwealth countries (the United States and Hong Kong). The Sri Lankan authorities did not indicate how many Commonwealth countries had been specified pursuant to the Act.

**Recommendation 32**

522. Sri Lanka was requested to provide extradition statistics including the nature and number of requests over the last number of years, how many requests were granted and how many refused and for what reasons as well as the length of time it takes to process such requests. Subsequent to the on-site visit, Sri Lanka provided information for 2005 which indicated that three extradition requests had been received by Sri Lanka. No further statistics were provided and it would appear therefore that such statistics are not maintained or readily available.

**Recommendation 37**

523. Dual criminality is a ground for refusal of assistance under the Mutual Assistance in Criminal Matters Act subject to the proviso mentioned earlier (for serious offences the central authority has discretion to grant assistance). For less intrusive or non-compulsory matters there does not appear to be any exception to the rule of dual criminality.

524. Technical differences between laws do not impede the provision of either forms of assistance. Generally, there are no legal or practical impediments to rendering mutual legal assistance or extradition where the conduct underlying the offence is criminal in both countries except that (under section 7) extradition will not be granted to another State where it appears to the Minister, committal court or the Court of Appeal that the offence is not an extraditable offence or:

- the offence for which extradition is sought is of a political character;

- the request is made to prosecute the person on account of his race, religion, nationality or political opinions; or
- the person might be prejudiced at his trial on account of his race, religion, nationality or political opinions.

525. Other specific refusal grounds include the rule against double jeopardy and refusal by the requesting State to provide assurances that the person sought will not be subject to other charges unless the Minister consents.

**Recommendation 39**

526. Offences are extraditable under the Extradition Act if they are either listed in an extradition treaty or are listed as such in the Schedule to the Act. Money laundering and terrorist financing (under the Convention on the Suppression of Terrorist Financing Act) are extraditable offences under the Act. However, the list of extraditable offences in the Extradition Act does not include all of the money laundering predicate offences listed in the PMLA as "unlawful activity"; nor does it contain a penalty threshold similar to that Act. Moreover, terrorist financing offences under UN Regulation No. 1 are not extraditable.

527. Sri Lanka can extradite its own nationals to other jurisdictions however the discretion of the Minister under the Act is wide enough to permit a refusal to extradite should be Minister deem that the offence would be one where Sri Lanka would wish to prosecute (assuming it had jurisdiction to do so).

528. Sri Lankan law contemplates that if a prosecution were to proceed in lieu of extradition, Sri Lanka would seek co-operation from the requesting country either through formal (mutual legal assistance) or other channels where available to obtain evidence for use in the prosecution.

529. There are no time limits in the Extradition Act for processing extradition requests and there are a number of factors which can impact on the time taken to finalise a request. The general extradition procedure under Part II of the Act requires first that the requesting State provide to Sri Lanka a copy of the arrest warrant or certificate of conviction for the person sought, the particulars of the accused, and the evidence to justify the issue of the warrant or supporting the conviction. After receipt of this information, the Minister may issue an authority to proceed to a judge who in turn may issue a "provisional warrant" under Sri Lankan law to arrest the person named. The person may then be brought before a court to determine whether there is sufficient evidence to commit him to trial under Sri Lankan law. If there is, the court may order that he be committed to custody to await his extradition.

530. The final decision to order extradition is the Minister's. Assuming a person is not successful in challenging the courts' order, the Minister may order extradition to the requesting State. However, the Minister may refuse to do so if the offence for which the accused is charged or convicted may expose the person to the death sentence or if it would be unjust or oppressive to extradite the person. The Minister may also refuse in the situation where there are multiple extradition requests. The Act provides grounds for preferring one jurisdiction over another.

531. Under the Extradition Act there is no "fast track" system such as an "endorsed warrant" procedure or other truncated procedures for certain specified countries such as exists in other Commonwealth jurisdictions in order to streamline procedures.

**Special Recommendation V**

532. As mentioned earlier in this report, there are two statutory instruments which create terrorist financing offences:

- Convention on the Suppression of Terrorist Financing Act No. 25 of 2005; and
- UN Regulation No. 1 of 2001.

533. The first creates offences of funding or financing terrorist acts, while the latter creates offences of financing terrorist organizations. Both are discrete forms of offences as required by the UN Convention on the Suppression of Terrorist Financing and UN Security Council 1373 (respectively). Offences under the Act are extraditable but offences under the Regulation are not. In addition, because of the lack of definition of the meaning of "funds" in the Convention Act there could be difficult issues arising in extradition matters around dual criminality. The Secretary for Foreign Affairs indicated that to date there have been no requests of Sri Lanka for extradition relating to terrorist financing nor has Sri Lanka made such requests.

6.4.2 RECOMMENDATIONS AND COMMENTS

534. Sri Lanka should:

- Maintain and make available comprehensive extradition statistics including how many requests are annually made and from whom, the nature of each request (offences and /or convictions), the time it takes to complete the request, the reasons for refusing extradition, how many requests were referred to the courts for provisional warrants, how many extradition orders were appealed and whether and why appeals were granted;
- Consider a fast track or simplified extradition procedure to permit extradition with certain designated countries on the basis of endorsed warrants of arrest or convictions only;
- Permit mutual legal assistance for less intrusive and non-compulsory matters;
- Provide that financing terrorist organizations are extraditable offences; and
- Insert a comprehensive definition of "funds" in the Convention on the Suppression of Terrorist Financing Act to ensure that issues of dual criminality do not result in refusal to grant extradition for terrorist financing offences under that Act.

6.4.3 COMPLIANCE WITH RECOMMENDATIONS 32, 37 & 39, AND SPECIAL RECOMMENDATION V

| | Rating | Summary of factors relevant to s.6.4 underlying overall rating |
|---|---|---|
| **R.32** | **Non-Compliant** | • **Sri Lanka either does not maintain comprehensive extradition statistics or they are not available** |
| **R.37** | **Largely Compliant** | • **Dual criminality should not be applied for less intrusive or non-compulsory matters for mutual legal assistance** |
| **R.39** | **Compliant** | **Recommendation fully observed** |
| **SR.V** | **Partially Compliant** | • **Not all terrorist financing offences are extraditable**<br>• **Lack of definition of "funds" in Convention Act means there may be problems with dual criminality requirements** |

## 6.5 OTHER FORMS OF INTERNATIONAL CO-OPERATION (R.32 & 40, & SR.V)

6.5.1 DESCRIPTION AND ANALYSIS

535. Section 16 of the FTRA authorises the FIU to disclose information to foreign institutions and agencies performing duties similar to those of an FIU. Although there are provisions in the FTRA and PMLA governing the arrangements and policy concerning international cooperation, the Evaluation Team was unable to examine the effectiveness of these provisions in practice given the very recent passage of the two Acts.

536. The Police Department is able to co-operate through normal police to police information exchange channels. Sri Lanka is a member of Interpol. The Interpol Unit, which is located within the CID of the Police Department, is the official agency to maintain official contact with other law enforcement agencies in foreign member countries in criminal investigations. The Interpol Unit is able to receive requests and provide assistance to foreign law enforcement agencies in criminal investigations. According to the statistics provided during the on-site visit, in 2005, the Sri Lanka received 209 requests for Interpol assistance from foreign countries which included the location of persons, providing information on terrorism and human smuggling etc. A total of 207 replies were sent. Sri Lanka sent 138 requests for assistance to other member countries during the same period and to date had received replies to 101 requests.

537. There is no general restriction imposed on the assistance that can be provided to other countries in criminal investigations. The Interpol Unit maintains regular liaison with domestic law enforcement authorities. Other law enforcement agencies, such as Customs Department, maintain their own gateways to co-operate and provide assistance to their overseas counterparts. According to the Customs Department, they have close and regular contact with the India Customs Department in particular. There is provision within the FTRA for the FIU, once established, to cooperate with its international counterparts.

538. In relation to international co-operation by financial sector regulators, there are no specific provisions in the Securities and Exchange Commission Act or the Regulation of Insurance Industry Act relating to international co-operation by the SEC or IBSL. In practice, given the recent passage of AML legislation in Sri Lanka, supervisors have not yet been involved in international efforts to combat ML or FT. Sri Lankan authorities advised that if requests are received by the authorities regarding money laundering or other offences, such information will generally be provided.

### 6.5.2 RECOMMENDATIONS AND COMMENTS

539. It is recommended that:

- When the FIU is set up it should ensure clear guidelines are developed to share information and intelligence with its foreign counterparts and to conduct enquiries for its foreign counterparts according to the powers conferred in the FTRA;
- The FIU should also maintain comprehensive statistics on the number of requests received, made and refused.

### 6.5.3 COMPLIANCE WITH RECOMMENDATIONS 32 & 40, AND SPECIAL RECOMMENDATION V

| | Rating | Summary of factors relevant to s.6.5 underlying overall rating |
|---|---|---|
| **R.32** | **Non-Compliant** | • **There are no statistics maintained on international assistance requests on ML and TF investigations** |

| R.40 | Partially Compliant | • **Interpol is the main agency handling requests to and from foreign law enforcement agencies in criminal matters.**<br>• **With the FIU not operational, there is no mechanism in place to deal with foreign requests and assistance in relation to ML specifically.** |
|---|---|---|
| SR.V | Partially compliant | • **There is provision for cooperation on TF matters through Interpol and police to police cooperation.**<br>• **FIU is not yet operational and there are no clear guidelines for co-operation with foreign counterparts.**<br>• **There are no record/statistics available to reflect the effectiveness of assistance provided in international efforts to combat ML or FT** |

# 7 OTHER ISSUES

## 7.1 OTHER RELEVANT AML/CFT MEASURES OR ISSUES

540. Sri Lanka emphasised to the Evaluation Team that it requires assistance from the international community to ensure the cessation of the violence by the LTTE in Sri Lanka. In order to curtail the activities of the LTTE, Sri Lanka recognises that it is necessary to put in place effective measures in respect of AML/CFT. Sri Lanka again stressed the importance of the provision of technical assistance in this regard by donors.

541. The Evaluation Team was pleased to note the coordinated and cooperative approach to technical assistance already being taken in Sri Lanka, both by the Sri Lankan authorities and by the AML/CFT donor community.

# 8 TABLES

**Table 1: Ratings of Compliance with FATF Recommendations**
**Table 2: Recommended Action Plan to improve the AML/CFT system**
**Table 3: Authorities' Response to the Evaluation**

### TABLE 1. RATINGS OF COMPLIANCE WITH FATF RECOMMENDATIONS

The rating of compliance vis-à-vis the FATF Recommendations are made according to the four levels of compliance mentioned in the 2004 Methodology (Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)), or could, in exceptional cases, be marked as not applicable (na).

These ratings are based only on the essential criteria, and defined as follows:

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|---|---|
| Compliant (C) | The Recommendation is fully observed with respect to all essential criteria. |
| Largely compliant (LC) | There are only minor shortcomings, with a large majority of the essential criteria being fully met. |
| Partially compliant (PC) | The country has taken some substantive action and complies with some of the essential criteria. |
| Non-compliant (NC) | There are major shortcomings, with a large majority of the essential criteria not being met. |
| Not applicable (NA) | A requirement or part of a requirement does not apply, due to the structural, legal or institutional features of a country e.g. a particular type of financial institution does not exist in that country. |

| Forty Recommendations | Rating | Summary of factors underlying rating[7] |
|---|---|---|
| **Legal systems** | | |
| 1. ML offence | PC | • Not all FATF designated offences are included as predicate offences to money laundering<br>• Third party predicate offenders may require prosecution prior to money laundering prosecutions<br>• Only domestic offences are considered predicate offences – not foreign offences<br>• Ancillary offences should include all requirements of the Palermo Convention |
| 2. ML offence – mental element and corporate liability | PC | • Penalty framework is not dissuasive<br>• The offences are not yet fully implemented |
| 3. Confiscation and provisional measures | PC | • The PMLA, UN Regulation No. 1 and Convention for the Suppression of Terrorist Financing Act do not apply to income, profits, instrumentalities of crime or property of |

[7] These factors are only required to be set out when the rating is less than Compliant.

| | | |
|---|---|---|
| | | corresponding value<br>• Freezing mechanism under Convention for the Suppression of Terrorist Financing Act is not without notice; the mechanism under the UN Regulation No. 1 is ineffective<br>• Terrorist Financing Act and Regulation contain no tracking procedures<br>• No mechanism to void fraudulent transactions |
| **Preventive measures** | | |
| 4. Secrecy laws consistent with the Recommendations | LC | • Laws do not prohibit collection of information by competent authorities but there are no provisions under which the information can be shared between competent authorities either domestically or internationally. |
| 5. Customer due diligence | NC | • Aside from rules applicable to securities accounts and primary dealers, there are no mandatory CDD requirements in force.<br>• The KYC guideline includes provisions for the identification of customers that are natural persons or entities, but the guideline is not enforceable.<br>• The FTRA covers the full range of financial institutions under the FATF standards, but is not yet in force.<br>• The FTRA is not specific about measures to be taken for customers that are individuals vs. measures for corporations and other entities.<br>• There is no requirement for the identification of beneficial owners or third parties.<br>• There is no requirement to understand the ownership and control structure of the customer.<br>• There is no requirement to obtain information on the purpose and nature of the relationship.<br>• There is no requirement to keep customer information up-to-date.<br>• Provision in respect of the identification of existing customers will be prescribed in regulations and are not in force |
| 6. Politically exposed persons | NC | • There is no legislative, regulatory or other enforceable requirement in respect of politically exposed persons |
| 7. Correspondent banking | NC | • There is no legislative, regulatory or other enforceable requirement in respect of correspondent banking relationships. |
| 8. New technologies & non-face-to-face business | NC | • There is no requirement for measures in respect of technological development or non-face-to-face business relationships. |
| 9. Third parties and introducers | NC | • The FTRA does not specify the application of the CDD requirements when business relationships are initiated through third parties and introducers, or the responsibility for meeting the requirements. |
| 10. Record keeping | PC | • Maintenance of records is still not a requirement under existing laws or enforceable regulations. The FTRA is still to be made operational and it is also recommended that certain amendments be made to, or regulations be issued under, the FTRA. Generally, however, in practice |

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| | | all financial institutions maintain records for a period of six years. |
| 11. Unusual transactions | NC | • There are no guidance notes or advisories issued by any authority to keep the financial institutions on their guard in respect of complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose. |
| 12. DNFBP – R.5, 6, 8-11 | NC | • The CDD requirements under the FTRA would cover all DNFBPs activities listed under Recommendation 12, but these requirements are not yet effectively in force.<br>• The deficiencies of CDD requirements applicable to financial institutions are also applicable to DNFBPs.<br>• The capability of authorities to enforce the requirements for casinos is doubtful. |
| 13. Suspicious transaction reporting | NC | • Though the FTRA provides for suspicious transaction reporting, in practice the system is yet to be established including setting up of an FIU. |
| 14. Protection & no tipping-off | C | • Recommendation fully observed |
| 15. Internal controls, compliance & audit | PC | • The new FTRA law has provided for the requirements but the efficacy can be assessed only after the Financial Sector Supervisors ensure that financial institutions integrate the AML/CFT requirements in their internal control procedures. |
| 16. DNFBP – R.13-15 & 21 | NC | • While DNFBPs are legally subject to the reporting and other requirements of the FTRA, effective supervision and implementation is lacking.<br>• Not all DNFBPs have a designated body (supervisor or SRO) to impose AML/CFT sanctions (applying Recommendation 17) |
| 17. Sanctions | PC | • As the FTRA has only very recently come into force, and the FIU is yet to become operational, there has been no implementation of penalties that are effective and dissuasive for non-compliance specifically with AML/CFT obligations. |
| 18. Shell banks | PC | • The bank licensing process effectively precludes the establishment and operation of shell banks.<br>• There is no enforceable prohibition on correspondent banking relationships with shell banks.<br>• There is no requirement for banks to establish that their respondent banks are not undertaking business with shell banks. |
| 19. Other forms of reporting | C | • Recommendation fully observed<br>• The intention to create a system of cash transaction reporting is evident, as the FTRA makes specific provision in this respect. |
| 20. Other DNFBP & secure transaction techniques | PC | • Sri Lanka has not yet undertaken a formal risk assessment of vulnerabilities to non-financial businesses and professions other than DNFBPs.<br>• No particular measures have been taken to reduce reliance on cash. |
| 21. Special attention for higher risk countries | NC | • There are no instructions, guidance notes or advisories to the financial institutions in respect of dealings with |

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| | | countries which do not apply or insufficiently apply the FATF Recommendations. |
| 22. Foreign branches & subsidiaries | LC | • The home/host country standard issues have been clearly covered in the FTRA. However the provisions are yet to be tested in live situations. |
| 23. Regulation, supervision and monitoring | NC | • While the recently passed FTRA and establishment of the FIU will improve the situation, apart from the issuing of the 2001 KYC Guidelines by the CBSL, to date there has been very little focus on AML/CFT regulation and supervision by industry regulators.<br>• Oversight of the foreign exchange dealers and money remitters is directed primarily at compliance with Exchange Control Act, and not at AML/CFT issues.<br>• Recent amendments in 2005 to the Banking Act provide for the requirement of fitness and propriety for directors and significant shareholders of banks. However, there are no requirements of fitness and propriety on other financial sector companies and intermediaries. |
| 24. DNFBP - regulation, supervision and monitoring | NC | • There is no AML/CFT supervision for casinos or other DNFBPs |
| 25. Guidelines & Feedback | NC | • FIU is yet to be established. Efficacy of the feedback system can be judged only after actual experience.<br>• Supervisory Institutions are yet to issue comprehensive supervisory guidance to the financial and non-financial institutions in respect of AML/CFT. Apart from the non-mandatory guidance note on KYC issued to banks in 2001 by CBSL, there appear to be no other relevant supervisory instructions.<br>• In the absence of an operational STR system, no feedback has been provided to reporting institutions.<br>• There are no existing guidelines for DNFBPs with regard to their obligations to comply with AML/CFT measures.<br>• There is no guidance on the obligations faced by DNFBPs to report suspicious or other transactions to a competent authority (e.g. FIU). |
| **Institutional and other measures** | | |
| 26. The FIU | NC | • The FIU is not in operation |
| 27. Law enforcement authorities | PC | • Designated law enforcement authorities on ML investigations have yet to be put in place as the PMLA has only just come into force |
| 28. Powers of competent authorities | LC | 29. A number of relevant powers are available in various legislation including the PMLA but the effectiveness of the powers has not been tested and further powers could be made available |
| 29. Supervisors | PC | • The newly enacted FTRA and other relevant Acts contain generally adequate powers and sanctions, however there has been a lack of effective implementation in relation to AML/CFT supervision.<br>• The respective roles of the FIU, when operational, and existing sectoral regulators in AML/CFT supervision need to be clarified to ensure effective implementation. |

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| 30. Resources, integrity and training | PC | • The FIU is yet to be staffed and operationalised.<br>• Supervisors and other competent authorities are generally adequately structured and staffed, but additional training is required on ML/CFT issues. |
| 31. National co-operation | PC | • Some mechanisms have been put in place but there is scope to improve co-operation/co-ordination at both operational and policy levels.<br>• The FIU is not operational and it is not yet clear exactly how the FIU will co-operate with the other domestic authorities in the relation to operational and policy aspects concerning money laundering and terrorist financing matters. |
| 32. Statistics | PC | • Overall there are a limited number of statistics are available to assess the effectiveness of the AML/CFT regime, only partly explained by the recent passage of relevant legislation<br>• Collection of statistics generally needs to be better coordinated |
| 33. Legal persons – beneficial owners | PC | • Trust and company service providers are not required to obtain, verify and retain records of the beneficial ownership and control of legal persons<br>• Sri Lanka should extend the rules relating to beneficial ownership information |
| 34. Legal arrangements – beneficial owners | PC | • Competent authorities have some powers to obtain access to information on the beneficial ownership and control of certain legal arrangements. Overall, the mechanisms in place are insufficient. |
| **International Co-operation** | | |
| 35. Conventions | PC | • Sri Lanka has not ratified the Palermo Convention |
| 36. Mutual legal assistance (MLA) | PC | • It is not clear whether Sri Lanka provides assistance in timely manner<br>• Sri Lanka has not considered devising a framework for resolving competing jurisdictional claims where prosecution in more than one country is at issue |
| 37. Dual criminality | LC | • Dual criminality should not be applied for less intrusive or non-compulsory matters |
| 38. MLA on confiscation and freezing | PC | • Sri Lanka cannot freeze laundered property or the instruments used in or intended to be used in offences<br>• Sri Lanka cannot confiscate property of corresponding value<br>• Sri Lanka has not considered establishing an asset forfeiture fund<br>• Sri Lanka does not have arrangements with other countries for coordinated seizure and confiscation actions |
| 39. Extradition | C | • Recommendation is fully observed. |
| 40. Other forms of co-operation | PC | • Interpol is the main agency handling requests to and from foreign law enforcement agencies in criminal matters.<br>• With the FIU not operational, there is no mechanism in place to deal with foreign requests and assistance in relation to ML and TF specifically. |

| Nine Special Recommendations | Rating | Summary of factors underlying rating |
|---|---|---|
| SR.1 Implement UN instruments | PC | • Sri Lanka has not fully implemented the Terrorist Financing Convention<br>• Sri Lanka has not fully implemented UN Security Council Resolutions 1267 and 1373 |
| SR.II Criminalise terrorist financing | PC | • The terrorist financing offences in the UN Regulation do not include funding a single terrorist<br>• The definition of "funds" in the Act and in the UN Regulation do not extend to what is required by the Terrorist Financing Convention<br>• Extra-territorial jurisdiction of offences under the UN Regulation is restricted to Sri Lankan citizens only<br>• Domestic jurisdiction over the UN Regulation offences is severely restricted to Sri Lankan citizens and residents only |
| SR.III Freeze and confiscate terrorist assets | PC | • Sri Lanka does not have an effective mechanism to freeze terrorist funds or other assets pursuant to Resolutions 1267 and 1373<br>• Sri Lanka does not have an effective and publicly known procedure for considering de-listing and unfreezing requests in a timely manner |
| SR.IV Suspicious transaction reporting | NC | • FIU is yet to be established. |
| SR.V International co-operation | PC | • It is not clear whether Sri Lanka provides timely mutual legal assistance<br>• Dual criminality should not be applied for less intrusive or non-compulsory matters<br>• Sri Lanka cannot confiscate the instruments used in or intended to be used in offences<br>• Not all terrorist financing offences are extraditable<br>• Lack of definition of "funds" in Convention Act means there may be problems with dual criminality requirements for extradition |
| SR VI AML requirements for money/value transfer services | NC | • There is no licensing or registration requirement for legal non-bank money remitters.<br>• Informal money remitters, while prohibited by law, are not subject to any AML/CFT provisions or effective supervision/dissuasion. |
| SR VII Wire transfer rules | NC | • No specific laws or enforceable regulations exist in respect of inclusion of originator information in wire transfers. The requirements under the Exchange Control Act do not require that originator information be transmitted nor do they collect sufficient information for inward remittance. Further these are not applicable to domestic wire transfers. |
| SR.VIII Non-profit organisations | PC | • Sri Lanka is conducting a comprehensive review of its NGO legislative framework. However, the review is not focused on terrorist financing.<br>• There has been no assessment of the overall vulnerabilities of the non-profit sector to terrorist financing or other abuse.<br>• There is insufficient monitoring of NGOs to ensure funds |

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| | | are used to achieve charitable objectives.<br>• There are no requirements to ensure the financial transparency of the NGO sector.<br>• There has been no education to NGOs on how to protect themselves from terrorist financing and other abuses.<br>• There is no specific guidance issued to financial institutions in respect of customers that are NGOs. |
| SR. IX Cash couriers | NC | • There is a declaration system in place for cross border transportation of currency but with no mechanism to ascertain origin of the currency and its intended use in relation to money laundering or terrorist activity<br>• There is no mechanism in place to maintain comprehensive statistics and pass the information on declaration of cross border transportation to the FIU which is yet to be established |

**TABLE 2: RECOMMENDED ACTION PLAN TO IMPROVE THE AML/CFT SYSTEM**

| AML/CFT System | Recommended Action (listed in order of priority) |
|---|---|
| **1. General** | |
| **2. Legal System and Related Institutional Measures** | |
| Criminalisation of Money Laundering (R.1 & 2) | • Establish courses/awareness training for judges, prosecutors and police to raise the level of awareness of the PMLA and to understand and detect the various forms of money laundering.<br>• Ensure the effective use of the PMLA by committing police resources to investigating and detecting this offence.<br>• Sri Lanka should immediately deposit its instrument of ratification to the Palermo Convention.<br>• The seven year offence threshold at section 35 of the PMLA should either be lowered to include the offences not currently included in the FATF designated category of offences, or alternatively, those FATF designated offences should be explicitly included as listed offences at section 35.<br>• The avoidance of doubt clause at section 3(3) of the PMLA should be amended to provide that a conviction by a predicate offender is also not required for prosecution of a money launderer not connected with the predicate offence.<br>• The definition of "unlawful activity" at section 35 of the PMLA should be extended to include conduct that occurs in another jurisdiction which either constitutes an offence in that jurisdiction or, if it had occurred in Sri Lanka would be unlawful activity in Sri Lanka.<br>• The ancillary offences at section 3(2) of the PMLA should be extended to include "facilitation" in accordance with the Palermo Convention.<br>• Sri Lanka should consider changing the penalty structure for money laundering offences to provide that it is more dissuasive. |
| Criminalisation of Terrorist Financing (SR.II) | • The offences in the UN Regulation should be moved into the Convention on the Suppression of Terrorist Financing Act No. 25 of 2005 and the penalties should be harmonized, preferably with the same penalty structure in the Act.<br>• The Act should incorporate the definition of "funds" as contained in the Terrorist Financing Convention.<br>• Once the Regulation offences are moved into the Act, the Act should further provide that those offences:<br>a. apply to funding both a terrorist organization and an individual terrorist<br>b. contain the requisite mental elements consistent with the Terrorist Financing Convention, and<br>c. have the same extra-territorial effect as the current terrorist financing offences in the Act.<br>• The Act should clarify what offences in the nine terrorist Conventions listed in Schedule 1 to the Act are applicable to terrorist financing – this could be achieved by inserting a comprehensive definition of "terrorist act" in that statute, and<br>• The Act should include a comprehensive definition of "person" to |

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| | include, at least, the entities contemplated in the FATF definition of "legal person" or, alternatively, the Act should clarify that the offence applies to the same entities to which the PMLA applies. |
| Confiscation, freezing and seizing of proceeds of crime (R.3) | • Consider the option of establishing a freezing, seizing and confiscation/forfeiture regime within a single statute (such as a Proceeds of Crime Act) which would consolidate and improve the existing mechanisms for dealing with, and managing, the proceeds of money laundering, terrorist financing and other crimes. One of the aims of single system would be to establish a fundamental consistency in the mechanisms used to confiscate proceeds.<br>• The confiscation regime should apply to the proceeds of, and instruments used in or intended to be used in the commission of, any money laundering, terrorist financing or other predicate offences;<br>• The regime should also apply to profits, income or other benefits generated from the proceeds of crime as well as property of corresponding value.<br>• There should be a clear, effective and workable interim freezing mechanism to freeze the proceeds of crime. The system contained in the PMLA whereby the Police may issue freezing orders subject to confirmation by the High Court is an example of such an effective system.<br>• Authorities, whether Police or otherwise, should have effective powers to identify, and trace property which may be the subject of confiscation.<br>• The interim freezing mechanism should be on an *ex parte*, without notice basis, in order to avoid the potential that assets sought to be confiscated will be secreted or dissipated within or outside Sri Lanka.<br>• The rights of third parties in assets subject to confiscation or freezing should be acknowledged by a mechanism which permits them to apply for relief.<br>• The regime should contain a mechanism whereby fraudulent or void(able) transactions designed to hide or dissipate assets to defeat freezing and confiscation action may be voided or ignored by authorities for this purpose.<br>• Sri Lanka should consider implementing a system whereby assets of criminal organizations may be confiscated and in conjunction with this implement a wider civil (non-conviction based) forfeiture system. |
| Freezing of funds used for terrorist financing (SR.III) | • Sri Lanka needs to establish clear and effective procedures for the implementation of UN Security Council Resolutions 1267 and 1373 (and their successor Resolutions) – the current UN Regulation is not clear in this regard and is of dubious legal authority for this purpose.<br>• Sri Lanka needs to incorporate UN 1267 Committee listed entities as early as possible into domestic law in order to comply with their international obligation to freeze any assets of those entities without delay.<br>• The procedures should include an effective, *ex parte*, asset freezing mechanism for listed entities.<br>• The procedures should also include a mechanism to give effect to foreign jurisdiction freezing orders. |

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| | • UN designated entities need to be communicated to banks and other financial institutions immediately pursuant to effective domestic procedures.<br>• Sri Lanka should establish a clear, effective, and public mechanism for de-listing terrorist entities, both for those listed/de-listed by the 1267 Committee and for those whom Sri Lanka chooses to list or designate under Resolution 1373. |
| The Financial Intelligence Unit and its functions (R.26, 30 & 32) | Sri Lankan authorities must ensure that the FIU:<br>• is made operational as quickly as possible;<br>• is set up under statute;<br>• should be given operational independence to ensure freedom from undue influence or interference;<br>• should be able to secure extra funding as necessary to expand its resources when necessary in order to ensure effectiveness and efficiency;<br>• should be provided with adequate and suitable training for staff in combating ML/TF and in financial analysis;<br>• should ensure staff maintain high professional standards and integrity and that information is securely protected and properly disseminated to appropriate agencies for action;<br>• should have regular and adequate co-ordination and liaison with domestic law enforcement agencies, financial institutions as well as overseas agencies;<br>• should apply for membership of the Egmont Group at the appropriate point;<br>• should work with the supervisors and regulators of all reporting institutions to formulate an effective and consistent guidelines on reporting and identifying of suspicious transactions; and<br>• should maintain comprehensive statistics on cash and suspicious transaction reports (STRs) together with the detailed breakdown on type of reporting institutions and the number of international assistance received. |
| Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32) | It is recommended that:<br>• coordinated training should be arranged for all enforcement and prosecution agencies in relation to the investigation techniques and prosecution of ML/TF offences;<br>• the use of controlled delivery and other special investigative techniques be introduced to assist law enforcement agencies to detect ML and FT offences;<br>• comprehensive statistics should be maintained on matters relevant to ML and TF so as to ensure the review system can be put in force and an understanding of typologies developed;<br>• effective national mechanisms should be set up to enable good coordination and cooperation between policy makers, the FIU, law enforcement and other competent authorities in Sri Lanka in combating ML and TF activities;<br>• FIU and law enforcement agencies and all competent authorities in combating ML and TF should be sufficiently funded, staffed and adequately structured so as to ensure operational independence and that they are able to perform their functions effectively. |
| Cross-border declaration or disclosure (SR.IX) | It is recommended that :<br>• There should be mechanism set up to allow suspicious cross border currency transportation incidents to be investigated by |

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| | competent authorities in relation to the origin of currency and its intended use.<br>• Cross border transportation of precious metals or stones should be declared with information made available to the FIU.<br>• A mechanism to maintain comprehensive statistics on cross border transportation of currency should be established.<br>• The Customs Department should establish relationships to enhance coordination and contact with other enforcement agencies both domestically and overseas for intelligence sharing and cooperation on cross border transportation reports. |
| **3. Preventive Measures – Financial Institutions** | |
| Risk of money laundering or terrorist financing | |
| Customer due diligence, including enhanced or reduced measures (R.5 to 8) | It is recommended that the FTRA or its regulations set out explicit requirements in the following areas:<br>• obtain information from the customer on the purpose and intended nature of the business relationship;<br>• ensure that customer information is kept up-to-date;<br>• determine whether the customer is acting on behalf of another person;<br>• obtain and verify information on the beneficial owners of accounts and transactions;<br>• for customers that are legal persons, understand the ownership and control structure and determine who are the natural persons that ultimately own or control the customer;<br>• perform enhanced due diligence for higher risk categories of customers, business relationships, and transactions;<br>• consider circumstances where reduced CDD measures would be acceptable; and<br>• set out an explicit timing for customer due diligence measures.<br><br>With regard to PEPs, the FTRA or regulations include requirements for financial institutions to have policies and procedures applicable to customers or beneficial owners that are PEPs, including obtaining senior management approval for establishing business relationships with a PEP, establishing the source of wealth and the source of funds and conducting enhanced ongoing monitoring.<br><br>Specific legislation should be introduced for correspondent relationship obligations. The requirements should include gathering sufficient information about a respondent institution assess the respondent institution's AML/CFT controls, obtain approval from senior management before establishing new correspondent relationships, and document the respective AML/CFT responsibilities of each institution.<br><br>Sri Lanka should establish legislative requirements for financial institutions to have policies and procedures to address risks arising from new or developing technologies, in particular Internet accounts. This would include specific CDD provisions when the customer is not physically present. |

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| Third parties and introduced business (R.9) | It is recommended that FTRA or regulations spell out specific requirements that financial institutions should follow, in the absence of contractual arrangements, when they rely on a third party to perform CDD. The provisions should specify that financial institutions:<br>• obtain the necessary customer information from the third party immediately upon the establishment of business relationship;<br>• satisfy themselves that the third party is able to provide the CDD documentation to them on a timely basis upon request;<br>• satisfy themselves that the third party is appropriately regulated and supervised and has measures in place to comply with the CDD requirements (e.g., it is located in a country that adequately applies the FATF Recommendations); and<br>• remain ultimately responsible for the proper performance of CDD measures and compliance with the FTRA. |
| Financial institution secrecy or confidentiality (R.4) | • There are no express provisions under which information can be shared between competent authorities either domestically or internationally. It is recommended that this be remedied through legislative amendment. |
| Record keeping and wire transfer rules (R.10 & SR.VII) | • To comply with the provisions of FATF Recommendation 10, it is necessary to either suitably amend the Act or to specify the requirement in Regulations framed under the Act.<br>• To comply with the provisions of SR VII, it is necessary to either suitably amend the Act or issue regulations under the Act to make collection and transmission of originator information mandatory in the case of all wire transfers. Guidance should also be provided regarding the course of action that a financial institution should take if the originator information has not been provided in the inward wire transfers. |
| Monitoring of transactions and relationships (R.11 & 21) | • There is a need to speedily establish a regulatory and supervisory regime whether exclusively by the FIU or separately by individual regulators and supervisors to issue guidance notes and advisories to the financial institutions. Depending upon the need to ensure uniformity across the entire breadth of financial sector and the special skills or requirements needed in each of the sectors, a 'hybrid' regime may also be considered where the broad framework is established by the FIU and the finer details are filled in by the individual supervisors consistent with the overall risk management approach.<br>It is also recommended that the authorities:<br>• Implement measures to require financial institutions to examine the background to transactions that are complex, unusual or have no apparent economic or lawful purpose, and to retain a written record of the examination in line with the underlying transaction record.<br>• Provide that financial institutions should pay special attention in relation to transactions and relationships that involve persons from or in countries that do not adequately apply the FATF Recommendations.<br>• Introduce a mechanism to alert financial institutions to those countries that are considered not to apply the FATF Recommendations adequately.<br>• Introduce an inter-agency procedure for determining whether specific counter-measures should be taken, in particular circumstances, against countries that do not adequately apply the FATF Recommendations. |

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| Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV) | • The provisions of the FTRA are generally sound. However, the FIU is yet to be established and reporting has not commenced. The effectiveness of reporting system is therefore yet to be established, as is the regularity and the quality of reporting.<br>• Reporting formats for making STRs and cash transaction reports should be prepared as soon as possible.<br>• Comprehensive statistics in respect of STRs and cash transaction reports should be maintained in digital form. |
| Internal controls, compliance, audit and foreign branches (R.15 & 22) | • Attention needs to be given by the regulators that internal control measures have a specific focus on AML/CFT issues. This should be done by the issuing of specific directions by financial sector regulators in respect of internal control procedures, independence of the compliance officer responsible for AML/CFT, training and appropriate hiring procedures.<br>• Care needs to be exercised that respective supervisors establish systems that would ensure that the financial institutions having foreign presence scrupulously follow the provisions of the law. |
| Shell banks (R.18) | • Sri Lanka should ensure that the enforceable prohibition on financial institutions from entering into, or continuing, correspondent banking relationships with shell banks is fully enforced. Sri Lanka should introduce an enforceable obligation for financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.<br>• |
| The supervisory and oversight system - competent authorities and SROs<br>Role, functions, duties and powers (including sanctions)<br>(R. 23, 30, 29, 17, 32, & 25). | • All supervisors should integrate the AML/CFT requirements into their directions, regulations and guidance notes etc. to the supervised institutions.<br>• Sri Lanka should clarify the role and powers for the regulatory agencies and the FIU to explicitly monitor for compliance with AML/CFT. It would be helpful if clear delineation is made as to the particular agency that would be in charge for monitoring for AML compliance by the relevant covered institutions.<br>• Establish a comprehensive training programme in AML/CFT issues for each of the regulatory agencies.<br>• Ensure that supervisory authorities and applicable sanctions apply for non-compliance specifically for AML/CFT purposes in each sector.<br>• Establish specific AML/CFT obligations and ensure supervisory authorities and appropriate sanctions powers are granted for violations in the insurance sector.<br>• Establish an AML/CFT supervisory capacity for money service businesses and exchange dealers by including AML/CFT provisions in inspection and auditing processes to encompass all the requirements as set forth by the FATF 40 Recommendations that must be applied to non-bank financial institutions.<br>• Establish sanctions authorities for non-compliance by money service businesses and exchange dealers. |
| Money value transfer services (SR.VI) | It is recommended that:<br>• Sri Lanka consider legalising illegal remittance services and establishing a registration or licensing system;<br>• registration and licensing also be required for money remitters that use commercial banks as their agents;<br>• appropriate monitoring be conducted to ensure compliance of |

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| | money remitters with the FTRA;<br>• consider establishing a task force to determine the true scale of alternative remittance, which includes all relevant policy, tax, enforcement, and investigative agencies;<br>• conduct outreach/education campaigns to help bring illegal remitters into the formal financial structure through licensing. |
| **4. Preventive Measures – Non-Financial Businesses and Professions** | |
| Customer due diligence and record-keeping (R.12) | • A money laundering threat assessment should be conducted for DNFBP sectors.<br>• Gaps outlined in sections 3.2 and 3.6 of this report should be addressed for DNFBPs.<br>• Consultation and outreach activities should be undertaken to inform the DNFBP sectors of the CDD obligations under the FTRA, and ensure that the requirements are adapted to the nature of activities of DNFBPs. |
| Suspicious transaction reporting (R.16)<br>(applying R.13-15, 17 & 21) | • There is a necessity either to establish supervisors for each of the sectors or to upgrade the industry associations to SRO status and require them to issue necessary directions, regulations and guidance to their members and to ensure compliance through periodic examination. Even a very developed and efficient FIU cannot replace the sectoral supervisors who have an in-depth understanding of their domains and can play a very important preventative role. |
| Regulation, supervision and monitoring (R. 24-25) | It is recommended that:<br>• the legal status of casinos in Sri Lanka be clarified, either by imposing and enforcing a prohibition on casino operations; or explicitly legalizing casinos and establishing a licensing and supervisory regime, including measures to prevent the ownership, control or management of casinos by criminals;<br>• consideration be given to establishing a regulator or SRO for the real estate sector;<br>• AML/CFT guidance be formulated and issued for each industry in the DNFBP sector;<br>• discussions be undertaken with the regulators and SROs of the DPMS sectors to determine the extent of their role in monitoring and ensuring compliance with the FTRA. |
| Other Non-Financial Businesses And Professions – Modern Secure Transaction Techniques (R.20) | • The authorities may consider formally assessing vulnerabilities of other non-financial businesses and professions and consider the need for any further regulatory AML/CFT coverage of this area.<br>• Measures should be developed to reduce the reliance on cash and to encourage the development and use of modern and secure techniques for conducting financial transactions that are less vulnerable to money laundering and terrorist financing. |
| **5. Legal Persons and Arrangements & Non-Profit Organisations** | |
| Legal Persons – Access to | • Require trust and company service providers to obtain, verify retain |

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| beneficial ownership and control information (R.33) | beneficial control information when acting for natural persons in forming corporate entities.<br>• Broaden the requirements to record beneficial ownership information on companies to ensure that information on natural persons is included when the forming entities of companies are two or more other companies. |
| Legal Arrangements – Access to beneficial ownership and control information (R.34) | • There is considerable scope to introduce or improve the processes in place to enable competent authorities to obtain or have access in a timely fashion to such information. Sri Lanka should enact more comprehensive measures to require that this data be collected or otherwise ensure that it can be made available in a timely manner. |
| Non-profit organisations (SR.VIII) | Sri Lanka is conducting a review of its NGO legislative framework to prevent the misappropriation of funds received by these organizations and improve compliance monitoring and sanctions. It is recommended that scope of the review include the risk of use and abuse of NGOs to fund terrorist activities.<br><br>To address those risks it is recommended that:<br>• effective coordination and information sharing mechanisms be implemented between the NGO regulatory authorities (including the Inland Revenue Department and the Ministry of Social Welfare and Social Service), the future FIU and law enforcement to share information on possible terrorist financing through NGOs;<br>• specific CDD requirements be applicable to institutions subject to the FTRA in respect of NGO accounts (e.g. request registration certificate, obtain information on the objectives and activities as well as directors / members);<br>• specific guidance and indicators be developed in respect of suspicious transaction reporting involving NGOs;<br>• ensure the financing transparency of NGOs (e.g. by requiring that annual financial statements be filed with the authorities);<br>• outreach be conducted among the NGO sector to raise awareness on the risks of abuse for funding terrorism;<br>• increased penalties be introduced for violations of the legislation and regulations applicable to NGOs;<br>• the authorities be provided with adequate resources to monitor the NGO sector. |
| **6. National and International Co-operation** | |
| National co-operation and coordination (R.31) | • There is significant scope to improve the level of co-operation and co-ordination between all relevant law enforcement agencies and also to enhance co-ordination at the policy level, possibly through the establishment of a formal national co-ordination mechanism, building on the recently established Steering Committee for the FIU, to include all relevant departments and agencies.<br>• Sri Lanka should ensure there are effective mechanisms put in place to enable policy makers, the FIU, law enforcement and other competent authorities to co-operate with each other to develop and implement policies to combat ML and FT. |
| The Conventions and UN Special Resolutions (R.35 | • Sri Lanka should ratify the Palermo Convention as soon as possible as well as take steps to more fully and effectively comply |

| & SR.I) | with UN Security Council Resolutions 1267 and 1373. |
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| Mutual Legal Assistance (R.32, 36-38, SR.V) | • Sri Lanka should maintain accurate records in relation to mutual legal assistance including, the annual number and nature of requests, how long each request takes to process, whether an why requests are refused and a list of countries which are specified under the legislation and those for which there is a treaty.<br>• Sri Lanka should permit foreign freezing orders to be enforced and allow for the instrumentalities and property of corresponding value to be confiscated.<br>• Sri Lanka should give thought to preparing departmental or policy guidance on prioritizing MLA requests.<br>• The Act should provide that MLA can be provided for less intrusive or non-compulsory matters in the absence of dual criminality (and not just for serious matters as the Act currently does). |
| Extradition (R.32, 37 & 39, & SR.V) | • Maintain and make available comprehensive extradition statistics including how many requests are annually made and from whom, the nature of each request (offences and /or convictions), the time it takes to complete the request, the reasons for refusing extradition, how many requests were referred to the courts for provisional warrants, how many extradition orders were appealed and whether and why appeals were granted.<br>• Consider a fast track or simplified extradition procedure to permit extradition with certain designated countries on the basis of endorsed warrants of arrest or convictions only.<br>• Permit mutual legal assistance for less intrusive and non-compulsory matters.<br>• Provide that financing terrorist organizations are extraditable offences.<br>• Insert a comprehensive definition of "funds" in the Convention on the Suppression of Terrorist Financing Act to ensure that issues of dual criminality do not result in refusal to grant extradition for terrorist financing offences under that Act. |
| Other Forms of Co-operation (R.32 & 40, & SR.V) | • When the FIU is set up it should ensure clear guidelines are developed to share information and intelligence with its foreign counterparts and to conduct enquiries for its foreign counterparts according to the powers conferred in the FTRA.<br>• The FIU should maintain comprehensive statistics on the number of requests received, made and refused. |
| **7. Other Issues** | |
| Other relevant AML/CFT measures or issues | • The Evaluation Team was pleased to note the coordinated and cooperative approach to technical assistance already being taken in Sri Lanka, both by the Sri Lankan authorities and by the AML/CFT donor community. |
| General framework – structural issues | |

## TABLE 3 AUTHORITIES' RESPONSE TO THE EVALUATION

### Provided by Sri Lankan authorities, 24 July 2006

Sri Lanka wishes to place on record its commitment to conform to the International standards on Anti-Money Laundering (AML) and Combating of Financing of Terrorism (CFT). Sri Lanka wishes to place on record the appreciation to the APG Secretariat in particular Mr. Eliot Kennedy who acted as the Principal Executive officer of the Secretariat, as well as the Head of the Evaluation team, the other members of the team namely; Dr. Gordon Hook, Mr. Vincent Jalbert, Mr. Prashant Saran and Mr. Francis Ming-kei Li for their commitment and the understanding of the situation in Sri Lanka due to terrorism in Sri Lanka, in conducting the evaluation.

Their visit to evaluate Sri Lanka coincided with the time the two relevant laws were certified by the speaker after its passage in Parliament. Sri Lanka considers it a great achievement that these laws could be enacted at a time when the county is facing several issues relating to terrorism, when even parliamentarians of the National Tamil Alliance created disarray in Parliament on the day when the bills were presented to Parliament to effectively prevent the passage of these two crucial bills. Hence, the constructive steps taken so far in relation to AML/CFT in an effort to comply with the International standards despite substantial difficulties posed by the prevailing domestic situation are considered praiseworthy.

The Liberation Tigers of Tamil Ealam (LTTE) have been waging war with the Sri Lankan Government to rule the North of Sri Lanka for more than 25 years and consequently attempts to cripple Sri Lanka's aspiration of becoming the regional financial hub. As explained by the delegation, in response to the question raised by one of the interveners at the plenary session of the AGM of the APG, terrorist financing through the collection of funds by front organizations posing to collect funds as humanitarian aid particularly during the Tsunami disaster which adversely affected the coastal belt of Sri Lanka in December 2004, gives the criminals the ability to fund their criminal activities and also to give them an opportunity to accept resources from outside the country. Hence, terrorism is a major challenge to national security interests in Sri Lanka.

The LTTE has an internationally organized network of fund raising both by legitimate and illegitimate means through their Front organizations. Although, it is projected that funds are being collected ostensibly for relief and charitable activities, the Sri Lanka Authorities point out that the empirical evidence is that these funds are very much being used by the LTTE to continuously upgrade its military capacity, and to augment its capital reserves for its international business operations. It has been internationally accepted that the LTTE is a terrorist organisation, consequent to which India, the United States of America, Canada and the European Union have proscribed the LTTE as a foreign terrorist organisation.

Every attempt is now being made to prevent Sri Lanka being used by criminals to exploit the weaknesses in the laws and the financial system for the purpose of money laundering and funding of terrorism

The technical assistance provided by the IMF to finalise the drafting of the laws relating to AML/CFT is placed on record with appreciation. The IMF indicated at the meeting at Manila that further assistance would be extended by the IMF to put in place an efficient and effective AML regime. In view of the commitment of Sri Lanka to conform to international standards in relation to AML/CFT, it looks forward for such assistance from the International donor community.

Further, Sri Lanka reiterates that it requires assistance from the International Community to ensure the cessation of the violence by the LTTE in Sri Lanka. At present a low intensity conflict continues in the North and East of the country with the number of casualties rising steadily. . . These acts of terrorism have taken its toll on the county's economy. As prevention of the flow of funds to the LTTE could curb their activities, Sri Lanka appeals to the international community to detect the means by which funds are channelled to the LTTE and to prevent such fund transfers for the procurement of arms. The law enforcement authorities are always ready to share any intelligence available with them with regard to terrorist financing with other International authorities.

Sri Lanka also appeals to the International community to strongly caution the LTTE and to impress upon them the urgent need to demonstrate a spirit of accommodation, compromise and good faith in engaging in peace negotiations or otherwise impose tangible and specific international sanctions both against the LTTE and front organizations operating in different countries. It was pointed out that such sanctions by the international community would create political space for the Government to continue with the ceasefire and the peace process.

It also wishes to place on record the courtesies and assistance rendered by the APG Secretariat in particular Mr. David Shanon, Executive Officer in finalizing the MER. Sri Lanka has established a working group to initiate action regarding the recommendations contained in the MER and few observations on the Table 2 are given below :

It also wishes to place on record the courtesies and assistance rendered by the APG Secretariat in particular Mr. David Shannon, Executive Officer in finalizing the MER. Sri Lanka has established a working group to initiate action regarding the recommendations contained in the MER and few observations on the Table 2 are given below:

| Relevant sections and paragraphs | Jurisdiction comments |
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| 1. ML offence | Sri Lanka has signed the Palermo Convention on Transnational Organized Crime and will be ratifying the same in September 2006 at the special Treaty Event to be convened by the United Nations during the 61st Session of the UN General Assembly. It is proposed to make the necessary amendments to the Money Laundering Act to ensure all requirements of the Palermo convention. |
| 5. Customer Due diligence | Customer Due Diligence requirements are now set out in Section 2 (2) of the FTRA and the FIU would issue the rules regarding same under section 2 (3) shortly. Requirements regarding update of customers will also be done under Section 2 (5) (c ) of the FTRA shortly. |
| 6. Politically exposed persons | "Consideration would be given to either amend the law or to make regulations under sub paragraph (m) of the definition of designated non-finance business under PMLA." |
| 10. Record Keeping | Provisions of Section 4 of the FTRA would be invoked and the "Institutions" to which the law applies would be required to comply with the provisions shortly. |
| 11.Unusual transactions | The observations are appreciated and action would be taken shortly. |
| 24. DNFBP – regulation, supervision & monitoring | Now that the FTRA is in force and AML/CFT applies action would be taken in relation to such activities of these Institutions. |

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| 25. Guidelines & Feedback<br>and<br><br>26. FIU | The FIU of Sri Lanka has been operationalised with effect from 1 June 2006 and the Cabinet of Ministers has appointed a Chief Executive Officer to Head the FIU. The existing Steering Committee set up to expedite matters relating to the establishment of the FIU has transformed itself to function as an advisory body to the FIU on all policy matters. The priority task of the FIU is the preparation of the organizational structure and the work programme of the FIU. The undertaking of a comprehensive risk assessment of money laundering and terrorist financing is among the priority areas identified by the FIU. |
| 30. Resources, integrity and training | Sri Lanka has sought the assistance of the international donor community in respect of the following :<br>a. Obtaining the financial assistance :-<br>(i) to acquire the software and hardware necessary for the collation of information from institutions governed by the Financial Transactions Reporting Act (FTRA). The CEO of FIU has prepared the business case document for the IT solutions. This would be presented to the donors by CEO – FIU for their comments.<br>(ii) to acquire the fax machines, photocopy machines and other office equipment necessary for the establishment state of the art FIU Office.<br>b. provision of training for the compliance officers of Institutions governed by the FTRA.<br>c. arranging awareness raising seminars on AML/CFT, legal framework and implementation issues.<br>d. arranging training programmes for the judicial officers to appreciate the provisions of law regarding the AML/CFT<br>e. arranging training for the FIU staff in detection of suspicious transactions and analysis of such reports.<br>f. training officers of enforcement agencies and the Bank Supervision Department, Non Bank Supervision Department, Exchange Control Department and the SEC to enhance the skills in combating money laundering and terrorism financing and the Financial Investigators with the relevant skills in conducting financial investigations. |
| 31. National co-operation | The initial Steering Committee established under the chairmanship of the Secretary, Ministry of Finance to set in place the FIU has now been converted to an Advisory Body and the committee comprises of over 18 persons who are the main stakeholders to ensure the smooth functioning of a AML/CFT regime in Sri Lanka. |
| 35. Conventions | Sri Lanka has signed the Palermo Convention on Transnational Organized Crime and will be ratifying the same in September 2006 at the special Treaty Event to be convened by the United Nations during the 61st Session of the UN General Assembly. It is proposed to make the necessary amendments to the Money Laundering Act to ensure all requirements of the Palermo convention. |
| 36. Mutual legal assistance (MLA) | On handling or prioritizing mutual legal assistance requests, the Sri Lanka Authorities inform that relevant authorities would determine the assigning of priority, taking into account the applicable principles that are generally resorted to, in the grant of Mutual Legal Assistance in |

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| | international practice, including the provisions in any agreement/arrangements in force between the Parties, the relative seriousness of the offences in question, the jurisdiction within which an offence was committed and the respective dates of the request etc.<br><br>There are also provisions in the Prevention of Money Laundering Act and the Suppression of Terrorism Act to render mutual legal assistance in terms of the Mutual Legal Assistance on Criminal Matters Act and also to render assistance on an Ad-hoc basis. |
| SR I Implement UN instruments | The UN regulation 1 was framed to give effect to the security council resolution 1373 as an interim measure. Now the convention for Suppression Financing Act No. 25 of 2005 is also in force. |
| SR IV Suspicious transactions reporting | FIU has been established since March 2006. |
| SR VIII Non-profit organizations | The documents submitted by Sri Lanka sets out the several measures that are being taken to address the existing inadequacies in the legal framework to ensure that funds are collected and used in accordance with stated charitable objectives. After the evaluation team visited Sri Lanka, a Parliamentary Select Committee on NGOs has been established with a wide mandate to examine all aspects of financing of foreign funded NGOs in operation in Sri Lanka including the transparency of the financing activities of such NGOs. Furthermore, the Central Bank of Sri Lanka has issued circulars to all licensed banks drawing their attention to the need to observe strict due diligence and the Know Your Customers (KYC) requirements with regard to inward remittances and outward transfers or withdrawal of funds from accounts operated by NGOs. The issue of terrorist financing by NGOs particularly Tamil Rehabilitation Organisation (TRO) is being examined at the highest political forums and all possible action is taken to arrest the funding of terrorism through NGOs. |

# 9 ANNEXES

## ANNEX 1: LIST OF ABBREVIATIONS

**AML** – Anti-Money Laundering
**APG** – Asia/Pacific Group on Money Laundering
**CBSL** – Central Bank of Sri Lanka
**CDD** – Customer Due Diligence
**CDS** – Central Depository Systems
**CFT** – Combating the Financing of Terrorism
**CID** – Criminal Investigation Department of Police Department
**DNFBP** – Designated Non-financial Business and Profession
**EFT** – Electronic Funds Transfer
**FATF** – Financial Action Task Force on Money Laundering
**FI** – Financial Institutions
**FIU** – Financial Intelligence Unit
**FT** – Financing of Terrorism
**FTRA** – Financial Transactions Reporting Act 2006
**GDP** – Gross Domestic Produce
**IBSL** – Insurance Board of Sri Lanka
**KYC** – Know Your Customer
**LSB** – Licensed specialised bank
**LTTE** – Liberation Tigers of Tamil Eelam
**ML** – Money Laundering
**MLA** – Mutual Legal Assistance
**MLAT** – Mutual Legal Assistance Treaty
**MOU** – Memorandum of Understanding
**NGO** – Non-Government Organisation
**PEP** – Politically exposed person
**PMLA** – Prevention of Money laundering Act 2006
**SEC** – Securities and Exchange Commission
**SRO** – Self-Regulatory Organization
**STR** – Suspicious Transaction Report
**UN** – United Nations
**UNSCR** – United Nations Security Resolutions
**UNTOC** – United Nations Convention against Transnational Organised Crime

## ANNEX 2: DETAILS OF ALL BODIES MET ON THE ON-SITE MISSION - MINISTRIES, OTHER GOVERNMENT AUTHORITIES OR BODIES, PRIVATE SECTOR REPRESENTATIVES AND OTHERS

### National authorities

Central Bank of Sri Lanka (various Departments)
Ministry of Finance
Ministry of Justice & Law Reforms
Attorney General's Department
Securities and Exchange Commission of Sri Lanka
Sri Lanka Police Department
Commission to Investigate Allegations of Bribery or Corruption
Ministry of Foreign Affairs
Ministry of Social Services and Social Welfare
Inland Revenue Department
Customs Department
Registrar of Companies

### National associations and self-regulatory organizations

Sri Lanka Banks' Association
Sri Lanka Accounting & Auditing Standards Monitoring Board
Institute of Chartered Accountants of Sri Lanka
Colombo Stock Exchange
Representatives of the Bar Association of Sri Lanka
Gem & Jewellery Association of Sri Lanka
Representatives of the Primary Dealers' Association
Finance Houses Association of Sri Lanka

### Private sector representatives

People's Bank
Commercial Bank of Ceylon Ltd
The Finance Ltd
Bank of Ceylon
Standard Chartered Bank

## ANNEX 3: LIST OF ALL LAWS, REGULATIONS AND OTHER MEASURES

Banking Act No 30 of 1988
Banking Amendment Act No.33 of 1995
Betting and Gaming Levy Act,
Code of Criminal Procedure Code
Commission of Investigate Allegations of Bribery or Corruption Act No. 19 of 1994
Companies Act No. 17 of 1982
Convention on the Suppression of Terrorist Financing Act No. 25 of 2005
Exchange Control Act
Extradition Act No. 8 of 1977
Finance Companies Act No. 78 of 1988
Financial Transactions Reporting Act No. 6 of 2006
Financial Transactions Reporting Regulations No. 1 of 2006
Gaming Ordinance
Mutual Assistance in Criminal Matters Act, No. 25 of 2002
National Gem and Jewellery Act, 1993
Penal Code
Prescription Ordinance
Prevention of Money Laundering Act No. 5 of 2006
Prevention of Terrorism Act No. 48 of 1979
Regional Development Banks Act
Regulation of Insurance Industry Act, 2000
Securities and Exchange Commission of Sri Lanka Act, 1987
Securities and Exchange Commission of Sri Lanka Rules, 2001
UN Regulation No. 1 of 2001
United Nations Act No. 45 of 1968
Voluntary Social Service Organizations (Registration and Supervision) Act 1980